IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

NO. 76-690

PIERRE J. LeLANDAIS & CO., INC.; PIERRE J. LeLANDAIS; RESEARCH & SCIENCE INVESTORS, INC.; INTERCONTINENTAL TECHNOLOGY & NATIONAL RESOURCES; CORONET FUND and CREATIVE CAPITAL FUND,

Petitioners,

-against-

MDS-ATRON, INC.; MOHAWK DATA SCIENCES CORP.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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OCTOBER TERM, 1976

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit dated May 5, 1976, which reversed in part the judgment of the United States District Court for the Southern District of New York dated January 8, 1974, which had awarded certain plaintiffs damages in the amount of $164,431.40.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Second Circuit is reported at _____ F.2d _____, and at Fed. Sec. L. Rep. ¶95,539 (CCH), and is included as Appendix A to this petition. The decision of the United States District Court for the Southern District of New York (Hon. Charles L. Brieant, Jr.), which awarded judgment to certain of the plaintiffs, is reported at 387 F. Supp. 1310 (SDNY 1974), and at 1974-1975 Transfer Binder Fed. Sec. L. Rep. ¶94,930 (CCH), and is included as Appendix B to this petition. Included as Appendix C to this petition are the orders of the Court of Appeals for the Second Circuit which denied the petition for rehearing.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. §1254(1) and §2101(c). The decree sought to be reviewed was rendered and entered on May 5, 1976. A petition for rehearing was denied on July 20, 1976. On September 30, 1976, Mr. Justice Marshall extended the time for this petition to and including November 17, 1976.

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in announcing an exclusive rule for measurement of merger fraud damages, thereby rejecting the Supreme Court rule calling for equitable flexibility in tailoring securities fraud remedies.

2. Whether the Court of Appeals erred in rejecting methods of damage measurement which previously had been developed by the Supreme Court and by the Court of Appeals for the Seventh Circuit.

3. Whether, in light of the newness of the rules announced in its decision in this action, the Court of Appeals erred in not remanding the action for further proceedings on the issue of damages.

STATUTES AND RULES INVOLVED

The damage questions involved are affected only by §28(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78bb(a)):

> ...no person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of.

The remand issue is affected only by 28 U.S.C. §2106:

> The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review,

and may remand the cause and direct the entry of such appropriate judgment, decree, or order, or require such further proceedings to be had as may be just under the circumstances.

STATEMENT OF THE CASE

This is a private action for damages under the Securities Exchange Act of 1934 ("1934 Act"; 15 U.S.C. §78a *et seq.*), more specifically under sections 10(b) and 14(a), as well as the rules of the Securities and Exchange Commission promulgated thereunder. The six plaintiffs were shareholders of Atron Corporation ("Atron"), which was merged into MDS-Atron, Inc., a subsidiary of Mohawk Data Sciences Corp. ("Mohawk"), on April 30, 1971. The defendants are Mohawk, MDS-Atron, and two individuals, former directors of Atron.

This action was tried in the Southern District of New York, to Honorable Charles L. Brieant, Jr., sitting without a jury. The district court granted a money damage judgment against MDS-Atron and Mohawk.*

* The district court dismissed the complaint of one plaintiff, International Technology & Natural Resources, S.A. ("ITNR"), as to all defendants, and it dismissed the complaint of all other plaintiffs as to the two individual defendants.

MDS-Atron and Mohawk appealed from the judgment against them,* and the Court of Appeals reversed.

Plaintiffs acquired their Atron stock directly from Atron, in private transactions in 1968 and 1969. Their stock was subject to restrictions on transfer, designed to prevent violation of the Securities Act of 1933. Atron stock of other shareholders, not so restricted, was traded in the over-the-counter market.

In January, 1971, Mohawk and Atron agreed in principle on a merger, with the exchange ratio to be one share of Mohawk for four shares of Atron. The formal merger agreement was signed on March 12, 1971.

On April 16, 1971, Atron issued a notice of a special meeting of shareholders to be held on April 30, 1971, for the purpose of voting on the proposed merger. The notice was accompanied by a proxy statement, by which Atron management solicited votes in favor of the merger. All of the plaintiffs received and read the proxy statement prior to submitting their proxies. With the exception of ITNR, all plaintiffs voted in favor of the merger. Due to mailing delays ITNR did not vote.

* Plaintiffs cross-appealed regarding the partial dismissals of the complaint, but the Court of Appeals did not reach the questions thereby raised.

At the special meeting of shareholders on April 30, 1971, the merger was approved -- by a vote of 924,756 shares in favor (99.7%), and 3,600 shares against (0.3%).

On the second business day following the vote on the merger, May 4, 1971 (April 30, 1971, was a Friday), Mohawk issued a press release announcing significant events bearing negatively upon Mohawk's business and its past financial performance. The matters revealed by the press release had not been disclosed to Atron shareholders prior to the vote on the merger the preceding Friday. Primary among the undisclosed facts (which the district court referred to as the "accounting change" deception) was Mohawk's decision to change its method of accounting for so-called "third-party" sales.

Mohawk's business was the manufacture and sale (or lease) of computer equipment. It engaged in financing transactions which it euphemistically referred to as "third-party" sales, and by falsely and deceptively accounting for such borrowings as sales it secretly inflated its income figures. Mohawk leased computer equipment to an end-user, normally for a stated term of five years (although the lease was cancellable at the will of the lessee) and thereafter sold the equipment, while subject to the lease, to a "third-party", a financing company. Mohawk collected the rent for the "third-party", but it was obligated to pay the full rent whether or not it collected from the lessee. Mohawk thus acted as a rent guarantor. In addition, if the lessee, by reason of default or cancellation, returned the

equipment, Mohawk was obligated to continue rent payments to the "third-party" or substitute another piece of equipment which was subject to an effective lease. During fiscal 1970 (August 1, 1969, through July 31, 1970) and the first six months of fiscal 1971 (August 1, 1970, through January 31, 1971) Mohawk accounted for such "third-party" sales by taking into income immediately the full amount which the financing company agreed to pay for the equipment. (The full price was not paid at the time of the "sales".)

In early 1971 the impropriety of Mohawk's method of accounting for "third-party" sales was recognized in discussions involving top management and the outside auditors. Professional criticism of the method in general was exacerbated at Mohawk by two factors -- the installment method by which Mohawk received the "sales" price, and the unexpectedly high rate of lease terminations. As a result, Mohawk determined to change to the proper method of accounting, whereby income was reported when equipment rents accrued rather than upon "third-party" sales. However, it withheld the announcement until after the Atron merger vote. The first announcement was in the May 4, 1971, press release, two business days after the merger vote. The change was retroactive, and when its effect was combined with other extraordinary items, the following downward adjustment or restatement of Mohawk's net income figures for fiscal 1970 and 1971 resulted:

	Unadjusted		Adjusted or restated	
	Net income	Net income per share	Net income	Net income per share
1970	$8,323,000	$1.52	$5,808,000	$1.02*
1971	$3,560,400**	$ .26	($1,050,000)	($ .18).

These highly significant reductions in Mohawk's performance (a one-third income reduction for 1970, and conversion of 1971 from a profit year to a loss year) were not disclosed in the proxy statement, which, as a result, materially overstated Mohawk's net income for the then current year and the preceding year. That inevitably misled and deceived plaintiffs and the other Atron shareholders who voted in favor of the merger, and the district court so found.

Based upon that finding (that the proxy statement was fraudulent), the district court proceeded to compute damages, awarding a total of $164,431.40. The district court held that the measure of plaintiff's damages was the difference in value between the stock they had given up and the stock they had received. The value of the stock given up was established by the amount defendants had agreed to pay for it in the merger, and the value of the stock received was established by the market

* Apparently $.23 of this $.50 adjustment is related to matters other than the method of accounting for "third-party" sales. The "pooling of interests" with Atron was one such other matter.

** Assuming 48% tax rate.

price when that stock first became saleable. The Court of Appeals reversed and dismissed the complaint, holding that the district court had used an incorrect method in establishing the value of the stock given up. By dismissing the complaint, without a remand for recomputation of damages, the Court of Appeals denied plaintiffs and the district court an opportunity to comply with its newly announced method of computing damages in merger fraud cases.

ARGUMENT

POINT I

THE DECISION OF THE COURT OF APPEALS DEVIATES FROM CONTROLLING PRECEDENT AND CONFLICTS WITH THE RULE IN THE SEVENTH CIRCUIT

In two important respects the decision of the Court of Appeals deviates from precedent authority. First, it announces an exclusive rule for the measurement of damages in private actions under §14(a) of the 1934 Act; i.e., it holds that in such cases there is only one acceptable way in which to prove damages. That holding is in conflict with *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), in which Mr. Justice Harlan stated:

> ...In selecting a remedy the lower courts should exercise "'the sound discretion which guides the determinations of courts of equity,'" keeping in mind the role of equity as "the instrument for nice adjustment and reconciliation between

> the public interest and private needs as well as between competing private claims." *Hecht Co. v. Bowles*, 321 U.S. 321, 329-330 (1955), quoting from *Meredith v. Winter Haven*, 320 U.S. 228, 235 (1943). (p. 386).
>
> . . .
>
> ...These questions, of course, are for decision in the first instance by the District Court on remand, and our singling out of some of the possibilities is not intended to exclude others. (p. 389).

Second, the Court of Appeals held that the value which defendants placed on plaintiffs' stock could not be considered as evidence of the value of that stock. That holding is in conflict with *Swanson v. American Consumers Industries, Inc.*, 475 F.2d 516 (7th Cir. 1973), also a corporate reorganization, proxy case. There the court valued the subject stock by adopting the valuation which had been placed on the stock by the parties to the plan of reorganization.

The decision in the present case thus creates a head-on conflict with *Swanson*. Factually the two cases are virtually identical. Like the Second Circuit in the present case, the Seventh Circuit in *Swanson* felt that an assessment of dissenters' appraisal rights, which had been lost by the plaintiffs, was the best approach to damages. Yet in carrying out that approach the Seventh Circuit did precisely the same thing that the district court did in the present case, it valued the stock

surrendered by the price fixed in the reorganization plan.

> ...In such a posture the appropriate remedy is to restore to the plaintiff shareholders the opportunity to receive cash rather than ACI shares. Therefore, ACI must offer to each Peoria shareholder $3.55, the market value attributed to Peoria stock in the reorganization plan, for each share of Peoria stock held by such shareholder on March 31, 1965, together with legal interest from that date to the date judgment is entered by the district court. (p. 521).

In the *Mills* case Mr. Justice Harlan suggested that damages could be computed by awarding plaintiffs the value of that which was represented as coming to them. (p. 388). Applying that principle to the present case, it was represented that plaintiffs had Mohawk stock coming to them, which had a New York Stock Exchange price, and therefore one acceptable remedy would be to award the price of that stock (less subsequent sale proceeds). In the present action plaintiffs argued for just such a remedy, and they presented proof of both elements in the calculation -- the market price of Mohawk stock on the date of the merger, and the amounts received by plaintiffs upon subsequent sales of that stock.

The appropriateness of that method of calculation is supported not only by *Mills*, but also by *Chasins v. Smith Barney*

& Co., 438 F.2d 1167 (2d Cir. 1970), an action under §10(b) of the 1934 Act, in which the Court of Appeals for the Second Circuit adopted precisely that method.

However, in the present action the district court chose to calculate damages in the manner exemplified by the *Swanson* decision. This was beneficial to the defendants because it resulted in an award lower than that produced by the *Mills - Chasins* approach. The district court recognized that prior to the merger the defendants themselves had placed a value on plaintiffs' stock. They had made that valuation at arms length, considering only their own best interests. The district court therefore validly reasoned that these defendants could not dispute the correctness of their own, self-interested valuation. Building on that premise, and following *Swanson*, the district court made its award by multiplying the number of shares owned by each plaintiff by the per share value which defendants had established.

Subsequently the Court of Appeals held that neither the *Mills - Chasins* approach (which had been urged by plaintiffs) nor the *Swanson* approach (which had been employed by the district court) was acceptable, and it substituted what it referred to as the "appraisal" method. In doing so the Court of Appeals acknowledged that it previously had not discussed this newly-announced "apprisal" method of calculating damages in §14(a) actions. Only in *Gerstle v. Gamble-Skogmo Inc.*, 478 F.2d 1281 (2d Cir. 1973), had it ever before considered §14(a) damage questions, and admittedly neither the phraseology nor the computational

methodology of that decision previewed adoption of the "appraisal" method announced in the present action.

POINT II

THE COURT OF APPEALS ABUSED ITS DISCRETION IN ANNOUNCING A NEW, DIFFERENT, AND EXCLUSIVE RULE OF DAMAGE CALCULATION WITHOUT AFFORDING PLAINTIFFS AND THE DISTRICT COURT AN OPPORTUNITY TO COMPLY WITH IT

As previously noted, *Mills* emphasized the flexibility and latitude which the district court is to be accorded in fashioning remedies under the federal securities laws. In the present action the Court of Appeals rejected two viable damage approaches and substituted a third. It is the exclusivity of its adoption of that third approach which most contravenes the holding of *Mills*.

Additionally, the approach announced by the Court of Appeals admittedly differs from all prior case law, and thus it could not reasonably have been anticipated by plaintiffs or the district court.

Under these circumstances the Court of Appeals should have remanded the action with instructions to the district court to rehear the question of damages in accordance with the newly announced method of computation. Dismissal of the complaint without an opportunity to comply with the new method

was unfair, and unusual. Commonly, on damage questions under the federal securities laws, the Court of Appeals for the Second Circuit (as well as other appellate courts) remands for further proceedings in accordance with the appellate holding. See, e.g., *Chris Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973), *cert. denied*, 414 U.S. 910 (1973), and the subsequent decision in the same case 516 F.2d 172 (2d Cir. 1975), in which the Second Circuit remanded with instructions on damages, and ultimately computed the damages itself after being dissatisfied with the district court's efforts not once but twice. The contrast between the attitude of the Court of Appeals in the *Chris Craft* decisions and its attitude in the present case is striking. In *Chris Craft* the district court had held that there was a failure of proof of any damages. Nevertheless the Court of Appeals remanded with instructions to conduct further proceedings in order to make a damage award. Indeed the Court of Appeals went so far as to outline the method of calculation to be used. Following remand, the Court of Appeals held that the district court had erred again in its damage formulation. Still the complaint was not dismissed. Remarkably the Court of Appeals calculated the damage award itself, raising the amount from approximately $1,600,000 to approximately $25,800,000. In the present case none of the *Chris Craft* latitude was extended to plaintiffs or the district court.

The *Chris Craft* contrast is even more notable when it is recognized that the Court of Appeals there sanctioned the very method of damage calculation which the district court employed in the present case

(and which the Court of Appeals subsequently rejected). In *Chris Craft* the court emphasized that arms-length, marketplace decisions on stock value are more reliable than "conceptual appraisals years later". (*Chris Craft* III, p. 186). It was just such an arms-length, marketplace assessment of value which the district court in the present case (and the Seventh Circuit Court of Appeals in the *Swanson* case) had accepted as evidence of value for damage purposes. Now, in the present case, in contradiction to its statement in *Chris Craft* III, the Court of Appeals for the Second Circuit has reversed field and decided that "conceptual appraisals years later" are *the only true measure* of damages, to the complete exclusion of arms-length, marketplace transactions.

The true and fair administration of justice requires that judicial discretion be employed even-handedly, and that in the present case there be further proceedings on the damage issue.

See also, *Edina State Bank v. Mr. Steak, Inc.*, 487 F.2d 640 (10th Cir. 1973); *World Products Inc. v. Central Freight Service, Inc.*, 342 F.2d 290 (3d Cir. 1965).

CONCLUSION

A writ of certiorari should be granted to permit this Court to resolve the conflict between the Second Circuit and the Seventh Circuit, and also to reaffirm the policy expressed in the *Mills* decision -- a salutary policy permitting the district courts due latitude in fashioning remedies under §14(a) of the 1934 Act. That policy is offended by the Second Circuit's decision in the present action -- not so much by the substance of the damage approach adopted, as by the outright rejection of the district court's equally meaningful approach which was supported by *Swanson* and ultimately by *Chris Craft* III. Additionally the failure to allow plaintiffs and the district court an opportunity to comply with the newly announced approach was an abuse of discretion. As in the *Chris Craft* decisions, plaintiffs' damages must not go uncompensated once liability for fraudulent acts prohibited by the securities laws has been found by the trial judge. Where unlawful behavior and injury are found they should be remedied.

Dated: New York, New York
November 15, 1976.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 136—September Term, 1975.

(Argued October 20, 1975 Decided May 5, 1976.)

Docket No. 75-7108

PIERRE J. LELANDAIS & CO., INC., PIERRE J. LELANDAIS, RESEARCH & SCIENCE INVESTORS, INC., INTERCONTINENTAL TECHNOLOGY & NATURAL RESOURCES, S.A., CORONET FUND and CREATIVE CAPITAL FUND,

Plaintiffs-Appellees and Cross-Appellant,

v.

MDS-ATRON, INC. and MOHAWK DATA SCIENCES CORPORATION,

Defendants-Appellants and Cross-Appellees,

and

JOSEPH S. STOUTENBURGH and RICHARD L. KARPEN,

Defendants.

Before:

FRIENDLY, MANSFIELD and TIMBERS,

Circuit Judges.

Cross-appeals from judgment entered after a bench trial in the Southern District of New York, Charles L. Brieant,

Jr., *District Judge,* awarding a total of $164,431.40 damages to certain of the plaintiffs for alleged violations by defendants of the federal securities laws, the award of damages having been based on a theory of estoppel rather than proof of actual damages.

Affirmed in part; reversed in part and remanded with directions to dismiss the remaining action.

MICHAEL C. DEVINE, New York, N.Y. (Schwenke & Devine, New York, N.Y., on the brief), *for Plaintiffs-Appellees and Cross-Appellant.*

MARTIN KLEINBARD, New York, N.Y. (Robert L. Laufer, Neal Johnston, and Paul, Weiss, Rifkind, Wharton & Garrison, New York, N.Y., on the brief), *for Defendants-Appellants and Cross-Appellees.*

TIMBERS, *Circuit Judge:*

On this appeal from a judgment in amount of $164,431.40 entered January 8, 1975, after a three day bench trial in the Southern District of New York, Charles L. Brieant, Jr., *District Judge,* 387 F.Supp. 1310 (S.D.N.Y. 1974), in a private damage action for alleged violations of Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§78j(b) and 78n(a) (1970), and Rules 10b-5 and 14a-9 promulgated thereunder, 17 C.F.R. §§240.10b-5 and 240.14a-9 (1975), in connection with a corporate merger, the question which we find to be dispositive is whether the district court erred in awarding damages to plaintiffs upon an estoppel theory, there being no proof of actual damages. For the reasons below, we hold that the district court did err. Accordingly, while we affirm the district

court's dismissal of two claims, we reverse and remand with directions to dismiss the remaining action.

I.

We shall summarize those facts which we believe necessary to an understanding of our ruling on the dispositive question before us. We assume familiarity with the more detailed statement of facts by the district court. 387 F.Supp. 1313-28.

The six named plaintiffs were stockholders of Atron Corporation (Atron). On April 30, 1971, Atron was merged into defendant MDS-Atron, Inc. (MDS), which was a subsidiary of defendant Mohawk Data Sciences Corporation (Mohawk).[1] Pursuant to the merger Atron's former stockholders received one share of Mohawk common stock for every four shares of Atron. Five of the six plaintiffs were among the overwhelming majority of Atron stockholders who voted in favor of the merger. The vote of plaintiff Intercontinental Technology & Natural Resources, S.A. (ITNR) was not cast for or against the merger.[2]

Plaintiffs acquired their restricted Atron stock directly from Atron in private placements during 1968 and 1969. Atron stock was traded in a thin over-the-counter market. Atron was a small, young company. It was engaged in the manufacture and sale of peripheral computer equipment

1 The other two named defendants, Joseph S. Stoutenburgh and Richard L. Karpen, were former officers and directors of Atron; Karpen also was an officer and director of Mohawk. The action was dismissed as against Stoutenburgh for lack of personal jurisdiction. It was dismissed as against Karpen upon a finding that his conduct was free of wrongdoing. No issue is before us with respect to these dismissals.

2 ITNR did not vote either way on the merger because the record holder of its stock did not forward to ITNR the proxy material in time for it to vote.

to computer manufacturers such as Mohawk. Ninety per cent of Atron's sales were to Mohawk at the time of the merger.

Prior to the instant merger, Atron had taken some preliminary steps with an eye to some form of merger. Nothing had come of these efforts. In January 1971, however, Atron was informed by Mohawk that the latter intended to exercise its contractual right to terminate its agreement with Atron and to begin producing itself the component which had been Atron's most important product. Two days following Atron's annual meeting of shareholders which had been attended by Mohawk, Mohawk proposed a merger which was agreed to upon the first and only discussion by Atron.

The January 29 merger agreement, announced the day it was proposed, provided for an exchange of stock at the 4:1 ratio stated above. This reflected the prevailing market price of the stock of the two companies.

The merger agreement was disclosed immediately to the public in a press release. The agreement was approved by Mohawk's Board of Directors on March 2. It was dated as of March 12. A proxy statement was mailed on April 16 to the Atron stockholders.

Focusing on the Atron stockholders, since their approval is all that we are concerned with here, each of the six named plaintiffs received and read the proxy statement. Five of the six plaintiffs voted in favor of the merger. The merger was approved by the Atron stockholders on April 30 by a 99.7 per cent majority: 924,756 in favor, 3,600 against.

Under the law of Minnesota where Atron was incorporated an affirmative vote of two-thirds of Atron's stockholders was necessary for approval of the merger. More than the statutory majority approved. Also under Minnesota law, as explained in the proxy statement, any dissenting stockholder who voted against the merger and followed the prescribed procedure was entitled to an appraisal of the "fair cash value" of his Atron stock and then was entitled to receive cash in that amount instead of Mohawk stock in exchange for his Atron stock.[3] No Atron stockholder sought to exercise his appraisal rights.

The instant action was commenced on May 25, 1972, more than a year after the merger. The theory of the complaint essentially was twofold.

First, under plaintiffs' "free stock deception" claim, they alleged that they were induced to vote in favor of the merger by a promise that they would receive unrestricted Mohawk stock in exchange for their restricted Atron stock. The district court found against plaintiffs on this claim for lack of proof, including determinations of credibility adverse to plaintiffs. 387 F.Supp. at 1318-24. We affirm the court's dismissal of this claim as not clearly erroneous.

Second, plaintiffs claimed that material information was omitted from the proxy statement. This claim was based chiefly on allegations that Mohawk had decided, but had not disclosed prior to the Atron stockholders meeting on April 30, 1971, to change its fiscal year from one ending July 31 to one ending April 30, to change the system of financing a small portion of its equipment, and to change from the financing method to the operating method of accounting for sales of leased equipment to unaffiliated third parties.

It was upon the second theory—alleged omission of material information from the proxy statement—that the district court awarded damages in favor of the five plaintiffs and against the two corporate defendants. It dismissed plaintiff ITNR's claim against the corporate defendants and the claims of all plaintiffs against the two individual

3 Minn. Stat. Ann. §§301.40, 301.44 (West 1969).

defendants. 387 F.Supp. at 1331-32. See notes 1 and 2 *supra.*

Defendants Mohawk and MDS appeal from the judgment in amount of $164,431.40, plus interest at 6% from April 30, 1971, entered against them jointly and severally on January 8, 1975. Plaintiff ITNR cross-appeals from that part of the judgment which dismissed the complaint as to it. We affirm on ITNR's cross-appeal; but on the appeals of Mohawk and MDS we reverse and remand with directions to dismiss the remaining action.

II.

We turn directly to the issue which we find to be dispositive of this appeal—the estoppel theory which neither side urged upon the district court but upon which the court based its award of damages in the absence of proof of actual damages.

The crux of the court's decision in this respect is that plaintiffs gave up appraisal rights to the fair cash value of their Atron stock worth $8.60 per share and received in exchange Mohawk stock worth $5.38, thus damaging plaintiffs in amount of $3.22 per Atron share. The manner in which the court arrived at these figures is set forth in the margin.[4]

4 The district court stated:

"Neither side of this litigation has presented persuasive evidence of the true value of Atron common stock as of April 30, 1971, contrasted with market price.

* * * * *

The Directors of Mohawk, who owed a fiduciary duty to their corporation and its other stockholders, had concluded that the value of Atron was $8.60 per share when they agreed in writing on March 12, 1971 to give a quarter share of Mohawk, then selling at $34.38 per share, for each share of Atron. *This agreement*, openly arrived at, and negotiated at arms length, at least insofar as Mohawk was concerned, *was effected under such circumstances as to estop Mohawk equitably from denying in this action that Atron stock had a value of at least $8.60.* There is no persuasive evidence to support any greater value, . . ." 387 F.Supp. at 1329 (emphasis added) (footnote omitted).

Although we would go a long way to prevent escape from liability for the issuance of a materially misleading proxy statement, see *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970);[5] *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964); *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2 Cir. 1973), there are limits and plaintiffs have outrun them here. Even if the proxy statement here involved was materially misleading—an issue which we do not reach—we find no basis whatever for the court's creation *sua sponte* of an "equitable estoppel" of defendants from asserting that Atron stock did not have a value of $8.60, i.e., one-quarter of the market value of a Mohawk share, on March 12 when the merger agreement was signed. Plaintiffs urge that the court's remedy was "rescissional in nature". On the contrary, it strikes us as an attempt to hold defendants not only to a promise they made but to one they did not make, namely, to pay cash in amount of $8.60 per Atron share.

Under elemental principles of equity, "a representation of fact made by a party who relies thereon with the right to so rely may not be denied by the party making the representation if such denial would result in injury or damage to the relying party." 1 Williston, Contracts § 139,

5 Plaintiffs generally in this type of case are fond of quoting from Justice Harlan's opinion in *Mills*, 396 U.S. at 386-89. Plaintiffs in the instant case are no exception. Actually he said very little that is helpful to them. After pointing out that the Court's affirmative conclusion on the issue of liability "implies nothing about the form of relief to which [petitioners] may be entitled", *id.* at 386, he also stated, "In short, damages should be recoverable only to the extent that they can be shown." *Id.* at 389.

This comports with the provision of Section 28(a) of the 1934 Act, 15 U.S.C. §78bb(a) (1970), that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages. . . ." See *Simon* v. *New Haven Board & Carton Co., Inc.*, 516 F.2d 303, 306 (2 Cir. 1975).

at 601-02 (3d ed. 1954); see Restatement (Second) of Contracts § 90 (Tent. Draft No. 2, 1965). That is the doctrine of equitable estoppel.

In the instant case, at no time did Mohawk represent to the Atron stockholders that their shares had a fair cash value of $8.60 per share. And yet that is the value the district court held that Mohawk is estopped from denying. The merger was a stock-for-stock exchange, not a stock-for-cash one. Whatever might be said regarding an estoppel approach if the merger had been a stock-for-cash one, we are not called upon to decide that issue. The stock-for-stock exchange here, as defendants point out, was based on the fact of commercial life that paper flows more freely than money. Furthermore, it is not uncommon for a company proposing a merger to offer a price including a premium which reflects a special value of the target company to the company proposing merger or is regarded as a necessary inducement to the voting shareholders of the target company to accept the proposal. We hold that the district court's award of damages based on a theory of equitable estoppel ignored the facts and is untenable as a matter of law.

This would not end the matter if plaintiff had presented any other competent proof of value. But the district court found that neither side presented persuasive evidence of the true value of Atron common stock as of April 30, 1971, contrasted with the market value, 387 F.Supp. at 1329. Rather than rely on that finding, we have made an independent search of the record ourselves to see if there is *any* proof of actual damages, whether adduced by plaintiffs or by anyone else. We have found none.

Absent the estoppel theory which we reject, our careful examination of the record discloses that plaintiffs failed to prove the value of what they gave up when they voted

for, rather than against, the merger. In terms of Minnesota law, note 3 *supra,* they failed to prove the "fair cash value", i.e., the appraisal value, of their holdings of Atron stock as of the date the merger was authorized. Loss of the value of their appraisal rights is the underpinning of their claim of damages. In short, they failed to prove what actual damages, if any, they sustained as a result of the exchange. Note 5 *supra.*

If such appraisal rights had any value, we have no doubt that such value could have been proven in accordance with well recognized corporate appraisal methods. There is no dearth of corporate valuation experts. They testify every day in various contexts, as indicated by many recent decisions of our Court.[6]

Since plaintiffs had ample opportunity, but simply declined, to adduce proof of what actual damages, if any, they sustained as a result of the exchange, we dismiss the action.

In view of our holding on the dispositive issue of damages, we do not reach any of the other claims of error

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6 See, e.g., *Gerstle v. Gamble-Skogmo, Inc., supra,* 478 F.2d at 1303-08, where we had a very complicated problem as to the measure of damages for a false proxy statement. A somewhat simplified statement of our result was that we allowed the minority stockholders of the merged company to recover the amount actually obtained on sales of certain properties concerning which undervaluing misrepresentations had been made, plus the value of other assets at the date of merger, less the market value of the stock which the minority stockholders received. This is not altogether unlike an estimate of what would be obtained on an appraisal, although we did not put it in those terms.

Plaintiffs in the instant case asserted no such basis of recovery. It seems fairly clear that the bottom line would be negative even if we were to take the Mohawk stock at the much lower value it had when plaintiffs were able to sell the restricted stock issued in respect of their restricted Atron shares.

In view of our holding on this issue, we see no useful purpose to be served in conjecturing as to what other alternative approaches plaintiffs *might* have pursued in seeking to prove damages. The record is clear that they had ample opportunity to present whatever proof they had. They declined to do so.

raised by defendants or the cross-appeal of plaintiff ITNR from the dismissal of its complaint.

We affirm the district court's dismissal of plaintiffs' "free stock deception" claim for failure of proof and its dismissal of the complaint as to plaintiff ITNR; but we reverse and remand with directions to dismiss the remaining action against defendants Mohawk and MDS for failure to prove actual damages.

Affirmed in part; reversed in part and remanded with directions.

APPENDIX B

PIERRE J. LeLANDAIS & CO., INC., et al., Plaintiffs,

v.

MDS-ATRON, INC., et al., Defendants.

No. 72 Civ. 2278-CLB.

United States District Court, S. D. New York.

Dec. 27, 1974.

Action was brought by holders of restricted stock in acquired corporation to recover damages against defendant acquiring corporation and others for violation of federal securities laws. The District Court, Brieant, J., held that plaintiff failed to prove any misleading proxy material or oral representations with respect to their claim that they justifiably believed they would receive unrestricted shares in acquired corporation but that they did establish that there were omissions of material facts from

proxy statement regarding accounting changes and changes in practice by acquiring corporation entitling them to damages.

Judgment for all except one plaintiff.

1. Corporations ⇐198(3)

With respect to proxy solicitation material, a corporation is entitled to deal in all respects with its shareholders of records.

2. Securities Regulation ⇐51

Statement in proxy soliciting material to effect that certificates for common shares of acquired corporation, about 71% of which was restricted by investment letter, should be exchanged for shares of acquiring corporation prior to sale or distribution as certificates of acquired corporation would not constitute good delivery of the acquiring corporation's stock on exchange did not constitute deceptive language to plaintiff sophisticated investors who asserted that statement implicitly said that all holders of acquired corporation would receive freely transferable stock of acquiring corporation. Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

3. Corporations ⇐584

Under Minnesota law concerning valuation of corporate shares where dissenters' rights are exercised in connection with merger, restricted corporate shares would receive same payment as that which would be given to unrestricted shares.

4. Securities Regulation ⇐51

Proxy statement relating to fact that the new common stock of acquiring corporation to be issued to effect merger be listed on the New York Stock Exchange was not deceptive to plaintiff sophisticated investors of acquired corporation's stock which was restricted by investment letter, on ground that inference was that the listing meant that each individual share certificate must be freely marketable, since the limitation meant it was freely marketable unless holder of security had agreed in writing that it was not freely transferable. Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

5. Securities Regulation ⇐144, 146

Plaintiffs suing to recover damages by reason of claimed violations of federal securities laws and regulations relating to deceptive statements and material omissions in proxy material arising out of corporate merger failed to prove claim that president of acquired corporation orally represented to investment adviser who allegedly passed it on that the plaintiffs holding restricted shares in acquired corporation would receive unrestricted stock of acquiring corporation. Fed.Rules Civ.Proc. rules 52, 58(1), 28 U.S.C.A.; Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

6. Securities Regulation ⇐106

Proxy solicitation material which became false or misleading had to be corrected by subsequent materials, so that insofar as directors knew or ought to have known that the facts originally disclosed subsequently became inaccurate they were under a continuing obligation to make certain that the proxy materials were amended and remained complete and accurate. Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

7. Securities Regulation ⇐143

In case based on nondisclosure of facts in proxy statement as well as case based on misleading statements therein, plaintiff to recover must show that the facts in question were material in the sense that a reasonable investigator might have considered them important in making his investment decisions. Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

8. Securities Regulation ⇐51

Totality of omissions in proxy material, including undisclosed fact that acquiring corporation as of date of proposed merger was changing accounting

practice with respect to its equipment sold subject to outstanding leases to nonaffiliated third parties with resulting restatement of earnings, that acquiring corporation would change fiscal year to coincide with merger and that it would discontinue its practice of third-party sales of its equipment, were material with respect to all but one plaintiff shareholder of acquired corporation's stock in that plaintiffs might have acted differently in connection with merger. Securities Exchange Act of 1934, § 14 (a), 15 U.S.C.A. § 78n(a).

9. Securities Regulation ⇐143

No proof of reliance is necessary to recover in case based on omission of material facts from proxy statement. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

10. Securities Regulation ⇐154

Measure of damages to holders of acquired corporation's stock because of acquiring corporation's omission of material facts from proxy material was compensatory, and the stockholders were entitled to be placed in the same position they would have enjoyed had they received the omitted information, voted against the merger and pursued their dissenting shareholders' rights of appraisal; there was no need to adjust damage to account for costs of obtaining appraisal remedy in state courts since plaintiffs incurred at least the same expenses in this litigation. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

11. Estoppel ⇐78(2)

Acquiring corporation was equitably estopped, in action by shareholders of acquired corporation for damages for violation of federal securities laws dealing with material omissions, to assert that for assessment of damage purposes the acquired corporation's stock was worth any less than the value acquiring corporation placed on it in agreeing to acquire the acquired corporation. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

12. Securities Regulation ⇐106

Where the omissions violated proxy rules and regulations promulgated thereunder and but for the violations plaintiff holders of merged corporation's stock might have voted against the merger, exercised their appraisal rights as dissenting shareholders and avoided damage, but for causation was sufficient basis to fasten liability on defendant acquiring corporation. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

13. Securities Regulation ⇐154

Where plaintiff stockholder in acquired corporation, which was entitled to damages because of defendant's violation of federal securities laws and regulations due to omissions in proxy material realized a profit when it covered the short sale of stock made in the mistaken belief that it was selling freely transferable shares of acquiring corporation which it was to receive as a result of merger, court in considering damages would give no consideration to profit realized on the short sale since plaintiff shareholder was not entitled to believe it was receiving unrestricted shares. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

14. Damages ⇐62(1)

At time registration statement became effective following merger, plaintiff shareholders of stock of acquired corporation came under an obligation to mitigate their damages arising out of their acquiescence in merger caused by material omissions in proxy material and a 30-day period following such date was a reasonable time in which plaintiffs should have disposed of their shares of acquiring corporation so as to mitigate damages; any plaintiff holding shares of acquiring corporation after the 30-day period was considered by court, for purpose of fixing damages, to have made a new investment decision. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

15. Securities Regulation ⟹154

Plaintiff holders of restricted stock in acquired corporation, who were misled by omissions in proxy materials submitted by acquiring corporation, were entitled to recover damages based on the difference between the lowest price for stock of acquired corporation during the 30-day period following the effective date of stock registration statement and the value placed on acquired corporation's stock by directors of acquiring corporation at time of merger agreement. Securities Exchange Act, § 14(a), 15 U.S.C.A. § 78n(a).

16. Securities Regulation ⟹106

Failure of plaintiff shareholder of stock in acquired corporation to vote either against the merger so as to be entitled to appraisal of shares under applicable state statutes or to vote for the merger so as to be entitled to claim that it suffered damage as result of the material omissions in proxy material barred any recovery on its part for violation of federal securities laws. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a).

17. Securities Regulation ⟹157

Court declined as a matter of discretion to award counsel fees to successful plaintiffs recovering for violation of federal securities laws dealing with material omission in proxy material in connection with corporate merger on ground that the damages were adequate to compensate plaintiffs and that the litigation had been unduly complicated and extended by plaintiff's act of joining a deception claim, which was lacking in merit, for trial with a relatively simple and clear cut claim under which they recovered. Securities Exchange Act of 1934, §§ 10(b), 14(a), 15 U.S.C.A. §§ 78j(b), 78n(a).

Butowsky, Schwenke & Devine, New York City, for plaintiffs.

Beekman & Bogue, New York City, for defendants.

FINDINGS AND CONCLUSIONS

BRIEANT, District Judge.

This action was initiated May 25, 1972 and tried before me without a jury commencing on February 11, 1974. The post-trial briefs and memoranda of the parties have been considered.

By their amended complaint filed June 1, 1973, plaintiffs assert numerous and variously stated claims against some or all of the defendants. The Court has subject matter jurisdiction of those claims pleaded under the federal securities laws, and pendent jurisdiction of common law claims pleaded, as well as personal jurisdiction over all of the parties except for defendant Joseph S. Stoutenburgh, upon whom personal service of the summons and complaint was never effected.[1]

Plaintiffs seek to recover damages by reason of claimed breach of §§ 14(a) and 10(b) of the Securities Exchange Act of 1934; Rules 14a–9 and 10b–5, arising out of the corporate merger hereinafter described. While eight (8) separate counts or causes of action are pleaded, it is unnecessary to summarize or list them.

A detailed pre-trial order was filed January 3, 1974. The stipulations and concessions of fact contained therein are incorporated herein by reference without specific restatement.

The Parties.

Plaintiffs are purchasers or successors in interest of purchasers of common stock of Atron Corporation ("Atron"), incorporated in Minnesota on November 27, 1968. Pierre J. LeLandais & Co., Inc., for purposes of this litigation, may be treated as the *alter ego* of Pierre J. LeLandais, whose Atron stock it acquired as beneficial owner. See Pre-Trial Order, ¶ 10. Intercontinental Technology & National Resources, S.A. (hereinafter "ITNR"), a Luxembourg corporation, became on or about November 18, 1969, the beneficial owner of Atron stock, originally purchased by plaintiff Research and Science Investors, Inc. ("RSI").

RSI is a Maryland corporation which refers to itself as a venture capital fund. ITNR is an investment fund. Plaintiff Coronet Fund ("Coronet") is a partnership in which Rudi E. Ludt is general partner. It is a venture capital fund. Ludt is by occupation a professional money manager. Creative Capital Fund ("Creative") is likewise a partnership operated as a venture capital fund in which Erwin LePow is general partner. LePow's prior professional experience is that of senior vice-president of a company listed on the American Stock Exchange. Mr. LeLandais' professional experience has been that of an investment banker and stock broker.

Plaintiffs may be classified as experienced and knowledgeable investors of the sort to whom the relatively meaningless description "sophisticated" is so often applied. Indeed, defendants claim, with some justification, that their adversaries are "super-sophisticated."

Defendant Mohawk Data Sciences Corp. ("Mohawk") is a publicly owned New York corporation whose common stock is and was at all relevant times registered and publicly traded on the New York Stock Exchange. It is and was engaged in the design, development, manufacture and sale, or disposition by rental arrangements having many characteristics of a sale, of electronic data processing equipment to be used by the ultimate computer customer. Defendant Richard L. Karpen was from January 1st to April 30, 1971 an officer and director of Mohawk, and a director of Atron. Defendant Joseph S. Stoutenburgh was President and a Director of Atron from its inception until April 30, 1971. Thereafter, until the date of trial, he was employed by a wholly owned subsidiary of Mohawk.

MDS–Atron, Inc. is a Delaware corporation wholly owned by Mohawk. It was formed as a corporate vehicle to effect a statutory merger of Atron whereby shareholders of Atron would acquire common stock of Mohawk, and Mohawk through its sole ownership of MDS–Atron stock would become in effect the owner of the business and assets of Atron. Atron merged with MDS–Atron, Inc., and in practical effect merged with Mohawk on April 30, 1971.

Factual Background.

A group of persons having special talents in the electronic data processing field, most of whom had previously been employed by Sperry-Rand, and participated thereby in the early development of "Univac", formed Atron in 1968 for the purpose of designing, developing and manufacturing computer equipment or components to be sold to original equipment manufacturers. At all relevant times, Mohawk was Atron's principal customer, to the extent of approximately 90% of sales, and in addition, Mohawk was a supplier of peripheral devices such as line printers and cardreaders to Atron for inclusion as components of Atron's systems.

In early 1971, Mohawk owned 195,000 shares of Atron common stock, and the Mohawk Pension Trust owned 16,000 shares, making a total of 211,000 shares out of 1,090,110 shares outstanding. Mohawk acquired some of its shares as original issue, and purchased the balance in January, 1969. All Mohawk's shares of Atron were purchased without registration under the Securities Act of 1933. All were subject to transfer restrictions, pursuant to a so-called investment letter, or otherwise, which prevented sale thereof by Mohawk without registration.

Mohawk, after January, 1971, had the contract right to terminate its purchases of Atron's principal product, and manufacture the product itself. Atron, in

1. Stoutenburgh was at all times available, and testified at the trial. This omission to serve process was called specifically to the attention of plaintiffs by Stoutenburgh's verified answer. That he was not served seems to have no practical bearing on the issues in this litigation, or the rights of the plaintiffs.

brief, was a single customer company, faced with the realistic possibility of losing that customer. It was operating at a substantial loss ($1,298,945.00 for its fiscal year ending September 30, 1970, and continuing during the months immediately prior to April 30, 1971), but it possessed $3,000,000.00 in uninvested cash or cash equivalent.

Most, if not all, of plaintiffs, had acquired their shares directly or indirectly as a result of the efforts of LeLandais, or securities firms with which he had been associated. In December, 1968, Mohawk, together with other principals of Atron, purchased its first stock issue. In the course of these sales to so-called "founders", SCI Capital, Inc., a wholly owned subsidiary of LeLandais' then employer Stralem & Co., investment bankers, bought 3,750 shares.[2] Later, of this stock, 1,668 shares were issued to LeLandais. Each of these shares were restricted as to transfer, and bore the customary legend on the certificates to that effect. In January, 1969, Mohawk purchased 187,500 additional shares. A private placement was effected that same month, in part through the efforts of LeLandais, and it was at that time that plaintiffs Coronet, Creative, LeLandais & Co. and RSI also acquired various holdings of Atron shares, all as detailed in the pre-trial order.

A second private placement took place in September, 1969, effected by Hamershlag, Borg & Co., an investment banking firm which then included LeLandais among its members. In January, 1970 Ladenburg Thalman & Co. sold 300,000 shares to the public pursuant to a registration statement. These shares were sold in units of one warrant and two shares.

All shareholders of Atron, except those who purchased through the Ladenburg offering, had purchased unregistered shares pursuant to so-called investment letters, given according to the custom and practice in the financial community. The Court finds that the purchaser plaintiffs had actual knowledge of the terms and conditions of their respective subscription agreements and the letters given in usual form, representing their investment intent. These plaintiffs specifically agreed with Atron that the shares to be received by them were to be restricted as to transferability and that the certificates representing these shares would carry a restrictive legend. Each purchaser represented that he or it was purchasing the Atron shares for investment purposes only, and not with a view to distribution, and agreed that the shares would not be sold unless registered with the Securities and Exchange Commission, or following receipt of an opinion from Atron's counsel that the shares could be sold without registration.

Each of these plaintiffs, sophisticated and experienced investors, had participated in similar purchases of investment letter stock in the past, and knew the nature, extent and legal effect of their express representations and agreements with Atron placing limitations upon resale of the Atron private placement shares they purchased.[3]

2. Atron stock was the subject of a reverse stock split, one for two shares in July 1969. Unless otherwise stated, all references are to the new shares.

3. Representative of the limitations is the legend on Atron stock certificate No. S-00026 issued to plaintiff Coronet Fund on November 24, 1969 (Exhibit No. 10), which reads as follows:

"The shares represented by this certificate have been purchased under investment presentations and no transfer or other disposition may be made except in compliance with the requirements of the Securities Act of 1933."

By undated letter physically attached to a Stock Purchase Agreement made as of January 16, 1969, Coronet, by the signature of R. E. Ludt, agreed with Atron as follows:

"The Purchaser hereby represents, warrants and confirms that Purchaser is acquiring the Stock for investment for Purchaser's own account and not with a view to, or for sale in connection with, any distribution of such Stock, and the Purchaser has no present intention of distributing or selling such Stock. The Purchaser acknowledges that the Stock is being issued and delivered without registration under the Securities Act of 1933 in reliance upon Purchaser's representation, as aforesaid. Purchaser hereby agrees that Purchaser will not resell or effect any other disposition of the Stock unless the Stock is duly registered under the Securities Act of 1933 or, in the opinion of counsel for the Company, such sale or disposition is exempted from such registration." [Exhibit 9]

We must exclude plaintiff ITNR from any of the foregoing generalizations. The shares which ITNR claims to own were purchased in a block of 5,000 in connection with the September, 1969 private placement through Hamershlag, Borg & Co. These certificates were originally issued to plaintiff RSI as investment letter shares, and RSI executed the subscription agreement, which included representations of an intent to hold as an investment. These shares were "sold" to ITNR on November 18, 1969. All that ITNR acquired at that time, or held at any relevant time, was equitable ownership. No letter of investment intent was given by ITNR to Atron or to RSI. On December 9, 1969, at the request of RSI, record ownership of this stock was placed in the name of Boyd & Co., a nominee of the Schroder Trust Company in New York. Payment to Atron was made by RSI at the time of issue of the shares, when ITNR had no funds.

On or shortly after September 17, 1969, Stoutenburgh, then President of Atron, received a letter (Exhibit 32) from the attorney for RSI who advised that his client

> "expects that it will transfer these shares to a new foreign investment company to which RSI expects to act as Investment Counselor. I understand that John French has discussed this matter with you, and I have discussed it with David Finkelman of Stroock & Stroock & Lavan. The transferee would take the shares, of course, subject to the rights and obligations of an Investor as stated in the Stock Purchase Agreement. Will you please have an officer of Atron execute the duplicate of this letter enclosed herewith to indicate that Atron agrees to this arrangement.
>
> The name of the foreign investment company is Intercontinental Technology & Natural Resources S.A. Its custodian in the United States is Schroder Trust Company, which usually requests that securities carried by it be registered in the name of its nominee, Boyd & Co."

Stoutenburgh, acting for Atron, endorsed a carbon copy of the above letter "receipt acknowledged". The Court interprets this acknowledgement of receipt to indicate agreement or acquiescence in the transaction by Atron, but finds no particular legal significance therein.

[1] On December 9, 1969 Boyd & Co., as nominee of Schroder Trust Company, did become the holder of record of ITNR's shares. With respect to proxy solicitation material a corporation is entitled to deal in all respects with its shareholders of record. See Vol. II, Loss, Securities Regulation, p. 876, and Vol. 5, Fletcher Cyclopedia Corporations, §§ 2007, 2053. If further authority be required for this simple proposition, see 17 CFR 240.14a-3(12)d, which became effective December 20, 1974. Adoption of this regulation by the Commission is some evidence that no such practice was required in 1971.[4]

4. This regulation, which is not retrospective, reads as follows:

"(d) If the issuer knows that securities of any class entitled to vote at a meeting with respect to which the issuer intends to solicit proxies, consents or authorization are held of record by a broker, dealer, bank or voting trustee, or their nominees, the issuer shall inquire of such record holder whether other persons are the beneficial owners of such securities and, if so, the number of copies of the proxy and other soliciting material and, in the case of an annual meeting at which directors are to be elected, the number of copies of the annual report to security holders, necessary to supply such material to such beneficial owners. The issuer shall supply such record holder with additional copies in such quantities, assembled in such form and at such a place, as the record

In 1971, a corporation such as Atron was not required to concern itself with whether nominees acting for offshore equitable owners of stock discharged their duties adequately, or communicated properly or sufficiently with their principals. When the owner of stock elected not to become the holder of record, but to place legal title in a nominee or custodian, or, as here, the nominee of a custodian, he accepted the risks consequent thereon. As will be seen below, ITNR at a critical point, "failed to get the word" from Atron or Mohawk, and was damaged as a result.

The Merger Proposal.

But, we are ahead of our story. We turn back to January 29, 1971, when, at Mohawk's invitation, Atron management met with officers of Mohawk, and agreed, subject to the approval of Atron's shareholders, that a merger would be proposed.

The Court finds nothing inappropriate about this suggestion, or its timing, or the way in which it was presented. There were good business reasons for the merger, both from the point of view of Mohawk and from Atron's position. Mohawk had the opportunity as a result of the merger to turn its restricted shares in Atron, a corporation undergoing a substantial monthly operating loss, into assets which had a net book value of approximately $4,300,000.00, of which $3,000,000.00 consisted of cash equivalents. Mohawk, together with its pension trust, owned approximately 19% of Atron.

Generally accepted principles of corporate democracy, which need not be amplified here, permit the shareholders to propose and vote upon a merger transaction, and grant to dissident minorities the right of appraisal. The Court finds no significance in the facts, taken separately or together, that the subject of a merger was tendered to Atron by surprise, two days following Atron's annual meeting of shareholders which had been attended by Mohawk; that the subject was raised with no prior notice; that the Atron officers agreed forthwith, and set the exchange ratio of one share of Mohawk for four shares of Atron, that Ladenburg Thalman & Co., then considering itself Atron's investment banker, objected strenuously to the merger at first; that the final terms were agreed upon in the first and only discussion; and that neither Atron nor Mohawk made any independent study or appraisal of the proposed merger; or that Atron made no attempt to seek out other more favorable merger partners.

As previously noted there were good business reasons for the merger. The parties had a right to merge. Even if it be concluded that the management of Atron acted hastily, this, under the entire circumstances of the case, was not inappropriate, and as noted, those who are aggrieved may vote against the proposed merger and exercise the appraisal rights granted to them by the statutes of Minnesota and most states, to receive the value of their shares in cash.

The agreement in principle to merge was made public immediately on January 29, 1971, by means of a press release. The record date for determination of Atron shareholders entitled to vote was fixed at March 26, 1971. The proxy solicitation material was mailed on April 16, 1971, for the meeting to be held at Bloomington, Minnesota on April 30, 1971.

At the time the exchange ratio was fixed, Mohawk was selling at slightly more than four times the price of Atron. The relative market prices of the two stocks was the principal factor relied upon by the directors of Atron and Mohawk in fixing the exchange ratio. Their decision was not unreasonable.

holder may reasonably request in order to address and send one copy of each to each beneficial owner of securities so held and shall, upon the request of such record holder, pay its reasonable expenses for completing the mailing of such material to security holders to whom the material is sent."

Atron faced difficulties, including an operating loss, and the possibility that its sole customer, Mohawk might, as it was permitted to do, seek a different resource, or manufacture the components itself. The market value of the Mohawk stock to be received was twice Atron's book value, two-thirds of which consisted of cash.

The Ladenburg firm expressed initial dissatisfaction with the exchange ratio of four shares of Atron for one of Mohawk. At a meeting held March 18, 1971, Mohawk's executive vice-president, Rifenburgh, convinced Ladenburg that the merger was prudent, and indeed necessary. Ladenburg indicated then that it would support the merger and urge its clients to do likewise. Following that date, Stoutenburgh expected to receive the favorable votes of those shares owned beneficially or of record by Ladenburg, and also the votes of any public shareholders who would rely upon or seek the opinion of Ladenburg.

On February 5, 1971, LeLandais, then affiliated with Merkin & Company, a stock brokerage house, mailed a letter and research report (Exhibit 27) to a number of Atron shareholders with whom he or his former firms had prior business relationships. The letter treats the projected merger as a *fait accompli*. The report neither favored nor opposed the merger, but expressed a view that Mohawk's future prospects did not justify its present high price earnings multiple, and that holders of Atron shares should consider the advisability of making sales, prior to the merger and exchange.

On February 17, 1971, Stoutenburgh, President of Atron, visited LeLandais at Merkin's office. Although LeLandais and Stoutenburgh did not at that time enjoy cordial relations, Stoutenburgh, in order to obtain a favorable vote, desired to explain why the proposed merger was advantageous. What took place at this meeting is discussed below in connection with the claim of deception concerning "free stock" (*infra*, p. 28).

On February 26, 1971, Stoutenburgh, continuing his missionary efforts, met with an officer of Morgan Guaranty Trust Company, which owned 40,000 Atron private placement shares, purchased in September 1969. After Stoutenburgh's explanation, Morgan advised that it would support the merger, and voted 40,000 shares in favor.

Seven hundred four shareholders of record were entitled to vote 1,090,110 shares of Atron common stock, and under Minnesota law, the affirmative vote of two-thirds of the outstanding shares (726,740) was required to approve the merger. As previously noted, Mohawk, and the officers, directors and employee founders of Atron and Halsey, held approximately 455,250 shares. The proxy solicitation was mailed on April 16, 1971, and within ten days, Atron's transfer agent reported that it had received proxies voting 770,649 shares in favor of the merger, and only 2,740 shares against. There was then no known organized opposition to the merger, and all persons including LeLandais, Ladenburg and Morgan, who had or controlled substantial positions, had supported the merger.

The "Free Stock" Deception.

Plaintiffs seek to recover on two separate theories, the first of which is the so-called "free stock deception" theory. Briefly stated, plaintiffs claim that they were deceived by the written proxy solicitation materials (Exhibit 18), and also by oral representations made on behalf of defendants to plaintiffs either directly or through their group leader, LeLandais, into believing they would receive unrestricted Mohawk stock on the merger.

[2] At the time of public announcement of the proposed merger, and thereafter, approximately 71% of the outstanding shares of Atron stock were restricted by investment letter. Nothing was said by Atron or Mohawk in the press release announcing the proposed merger about the effect, if any, of the

merger on these investment letter restrictions. The proxy statement, dated April 16, 1971, was received by all plaintiffs except ITNR, within a few days after its date and read. Plaintiffs found their argument in part on a contention that the proxy statement "*implicitly* . . . stated that all holders of Atron stock would receive freely transferable Mohawk stock" (Plaintiffs' Post Trial Memorandum, p. 8, emphasis added). There is no substance whatever in this argument. The provisions of the proxy statement, upon which reliance is placed, are found on pages 5 and 9 of the proxy statement. On page 5 it is stated that:

> "Certificates for Atron common shares should be exchanged for Mohawk certificates prior to sale or disposition since Atron certificates will not constitute good delivery of Mohawk common stock on the New York Stock Exchange."

Plaintiffs claim that they inferred from this indisputably correct and relatively standard boiler plate language, that Atron was informing them that the transfer agent will exchange Atron certificates for Mohawk certificates which will be in form satisfactory for delivery in transactions with member firms, that is to say, unrestricted and without any legend. There is no basis for drawing this conclusion. Atron did have considerable unrestricted stock outstanding. The restrictions and representations contained in the investment letters are self-executing, wholly without regard to whether the certificates bear a restrictive legend. The restrictive agreements or investment letters were clear, and their traditional meaning well known to plaintiffs. The Atron stock had been held by plaintiffs for relatively short periods. Plaintiffs each had substantial experience in dealing with restricted stock purchased from other issuers. It was generally known in 1971 by such investors that a merger was foreseeable when the state of mind represented to exist in their investment letters came into being, and that the mere occurrence of a subsequent merger is not one of the accepted changes of circumstances upon which counsel may found an opinion relieving parties to an investment letter therefrom and approving sale without registration. If plaintiffs drew the contrary inference subjectively, which they say they did from the provisions on page 5, that inference was unwarranted and unreasonable, and is no basis upon which to hold Atron or Mohawk liable for misleading proxy information released in violation of Rule 14a–9 or otherwise.

Plaintiffs also rely on those provisions of the proxy statement devoted to dissenters' rights under the statutes of Minnesota regulating the internal affairs of corporations. At page 9 of the proxy statement, Atron shareholders are informed that dissenters may obtain "the fair cash value" of their shares. No distinction is made between restricted and unrestricted Atron stock in this paragraph, and plaintiffs assert that because the information concerning dissenters' rights "does not state that fair cash value would be reduced as a result of any transfer restrictions," the reasonable reader is entitled to infer that in appraising dissenters' stock, all would be considered unrestricted. This latter proposition appears valid. We are cited to no provision of Minnesota law which would permit or require that stock of a dissenter, restricted as to transferability, would be valued less than unrestricted stock. In a proceeding to appraise the shares of dissenters in New York, mere market value, concededly higher where a corporation is publicly traded, for unrestricted stock than for restricted shares, is not the sole criterion in fixing value, nor is it even a major factor. Most courts applying statutes *in pari materia* with the Minnesota provisions, have long held that the value of shares where dissenters' rights are exercised in connection with a corporate merger is their full and fair investment value, taking into consideration that:

> "Offers for merger and consolidation are likely to be made to a corporation and accepted by it when the market price of its stock is depressed in relation to certain other valuation criteria . . . . Therefore, limiting the dissenter to the market price of his shares may enrich the majority at his expense. * * * [T]he theory of the dissenter's claim is that he desires a continuation of his investment unaffected by the change.
>
> The resultant valuations have generally concentrated on three principal elements: (1) net asset value; (2) market value; and (3) investment (or earnings) value. Most courts have considered all three. . . ." 79 Harv.L.Rev. 1456–7, Valuation of Dissenter's Stock (1966).

See also 15 Fletcher Cyclopedia Corporations, 1973 Revised Volume, § 7165.4, p. 294:

> "The courts must determine the value of the shares of dissenting stockholders. . . . Appraisal must be upon a going concern basis rather than upon a liquidation basis.
>
> While there is no legal formula which can be enunciated or applied in valuation proceedings, the appraisal remaining a matter of judgment on the facts in each case, the court can reiterate accepted principles, which simply stated, are that the appraisal should take account of market value, investment value, and net asset value."

[3] In the absence of authority to the contrary, we conclude that the Minnesota law is to the same effect, and that in a dissenters' proceeding, restricted shares would receive the same payment as would be given to unrestricted shares. Indeed, to hold otherwise would seem to permit undue oppression of shareholders who had in good faith purchased unregistered shares with the intent of holding a long term investment position in the issuing corporation. Such investors, to the extent that they were holding for the long term investment, or going concern value of their shares, were not prejudiced by the presence of the restriction unless there were a merger.

[4] LeLandais also contended at the trial that because page 5 of the proxy statement imposed a condition precedent to the merger, that the new Mohawk common stock to be issued to effect the merger be listed on the New York Stock Exchange, he inferred that such listing meant that each individual share certificate so issued must be freely marketable. In his testimony (Tr. p. 202) he conceded however, that this limitation meant that "it is freely marketable unless the holder of that security has agreed in writing that it is not freely transferable." Each plaintiff had so agreed in writing.

The Court considers the proxy statement not misleading with respect to the free stock deception claim, and believes that if any of these plaintiffs drew the inference therefrom which they say they did, it was entirely unwarranted, and may not be a basis for fastening liability on defendants.

Oral Misrepresentations.

[5] As an independent basis urged in support of the "free stock deception" theory, plaintiffs rely on oral communications said to have been made to them through LeLandais.

LeLandais testified, and I find, that he wrote Exhibit 28, a letter dated April 19, 1971, on the letterhead of Merkin & Co., directed to those Atron shareholders whom he or his prior firms had served, and that he did so prior to receipt of the proxy solicitation materials dated the same day. In his letter, he withdrew somewhat from the position of his February 5, 1971 letter and advised his followers that "the proposed merger . . . is to the best interests of all of the Atron Stockholders and to you as one of the participants in the Private Placements of securities which I effected and, therefore I strongly recommend that you vote in favor of this merger." He testified that the letter was "trig-

gered" by a disputed telephone conversation he claims to have had with Stoutenburgh on the same date. LeLandais' version of the telephone conversation is as follows [Tr. p. 205]:

"A Mr. Stoutenburgh said, 'Pierre, I would like you to do me a favor.' I said, 'What can I do?'

He said Ladenberg-Thalman was against the merger and he was afraid that unless he received enough proxies, the merger would not go through. And he said, 'If you really want your participants in your private placements to receive their free stock, you had better canvas them and get them to send their proxies in voting in favor of the merger.'

Q Was anything more said to the best of your recollection?

A I mean that's what I recollect of the conversation.

Q After April 19, 1971, but before April 30, 1971, did you have any discussions with either Mr. LePow, Mr. Ludt or Mr. French which related to the proposed merger in any way?

A Yes.

Q Did you speak with all of those gentlemen at different times?

A Yes.

Q And did you relate to all of those gentlemen the substance of your conversation with Mr. Stoutenburgh?

A Yes."

The April 19, 1971 letter does not state expressly or implicitly that any representation had been made by Mohawk to the effect that Atron restricted shareholders would receive unrestricted Mohawk stock. The letter thus makes no mention whatsoever of what is now testified by LeLandais to be the sole cause for writing it. The Court finds this testimony incredible. Plaintiffs have not proved to my satisfaction that the conversation with Stoutenburgh took place as claimed. There is no corroboration for the conversation, and competent credible evidence exists directly to the contrary.

LeLandais testified that between April 19th and April 30, 1971, he related the substance of his claimed conversation with Stoutenburgh to LePow and Ludt. LePow's corroboration of LeLandais' testimony concerning the oral representation of April 19th, claimed to have been made by Stoutenburgh, is extremely weak. He testified (p. 16) that they "rediscussed or discussed us getting free stock in the merger." LePow admits (p. 31) that there was nothing in the proxy statement which "led me to believe it one way or the other," with respect to whether the Mohawk stock to be received in exchange would be free of the investment letter restrictions. Ladenburg's opposition to the merger, said to have been the cause expressed by Stoutenburgh for his concern, had collapsed a month before the claimed telephone call.

LePow admitted again (p. 49) that there was nothing in the proxy statement which indicated that Creative would or would not receive freely transferable Mohawk stock.

Ludt testified (Exhibit 35, p. 19) that he spoke with LeLandais only once concerning the proposed merger. His testimony was as follows:

"A Well, essentially the subject of the conversation was on interpretation of what the intent was with respect to the shares that the Atron shareholders would receive from Mohawk Data.

Q What was your understanding?

A My understanding was that we would get freely negotiable shares.

Q In return for the restricted shares you held in Atron?

A Yes.

Q Had you arrived at that understanding totally on your own efforts or through conversations with other people?

A Well, I arrived at that understanding by reading the proxy statement, and I wanted to confirm my understanding, and I talked to Pierre as to whether this was the intent, and I received an affirmative reply.

Q Can you recall more specifically what Mr. LeLandais told you?

A He said that we would get free stock, freely negotiable stock.

Q Did Mr. LeLandais tell you how he knew that?

A Well, the language of the proxy statement, in my judgment, makes this quite clear.

Q Did Mr. LeLandais tell you what made it quite clear to Mr. LeLandais?

A I think the same language and conversation which I think he had with the Atron people.

Q Did he specifically refer to conversations that he had with Atron people?

A I think he was in fairly frequent conversation with them.

Q Did he specifically tell you that he had spoken to Atron people?

A I would have to say, no."

If in fact a seasoned stockbroker such as LeLandais had received the bald representation or interpretation which he claims to have received from Stoutenburgh, and later the written proxy solicitation materials did not bear this out, one would think it would be normal and ordinary procedure for him to have given Ludt the substance of his discussions and perhaps it is not too much to expect that he would have confirmed it in writing to LePow and Ludt as well as Atron.

LeLandais' pre-trial deposition with which he was confronted (p. 227, et seq.) is inconsistent with his trial testimony that he had imparted the good news to LePow and Ludt. I conclude that he was testifying more accurately on his pre-trial deposition than at trial, and decline to accept his testimony that he informed LePow and Ludt of the claimed oral representations made to him by Stoutenburgh.

On his deposition with respect to the claimed telephone conversation of April 19th, LeLandais testified that Stoutenburgh had called him. At trial he disclaimed memory as to whether he had called Stoutenburgh, or whether Stoutenburgh had called him. Confronted with his prior testimony, he qualified his position (p. 235) "when I talked to him [Stoutenburgh] I don't know whether it was the call he initiated, or whether it was my secretary that returned the call to him. But obviously *the first call came from Mr. Stoutenburgh* if there were two calls."

Joan Kane, formerly secretary to LeLandais, showed an entry on Monday, April 19th, in a desk diary kept in Merkin's office, which reads "Stoutenburgh Re: Proxy material." She says that this entry reflects a call from Mr. Stoutenburgh to Mr. LeLandais in which Stoutenburgh told Kane that he wanted to speak to LeLandais regarding proxy material, to which the witness responded in substance, "thank you, I will tell him." At most, the entry shows that Stoutenburgh was trying to reach LeLandais on the telephone on April 19th. Stoutenburgh testified that during the period between the agreement to merge and the shareholders meeting, he believed that Atron shareholders, with the exception of the promotors, would receive freely transferable Mohawk stock.

Personal bitterness existed between LeLandais and Stoutenburgh, and each held the other in low esteem because of an unrelated matter. Stoutenburgh testified (p. 256) that he visited LeLandais in person on February 17th, "as much as I desired not to have any dealings with Mr. LeLandais." He believes that in that meeting he indicated to LeLandais the attitude of Mohawk management that they would give unrestricted shares if they could. He testified that he had no recollection of speaking to LeLandais in April of 1971, and during the period "there was every reason not to have called Mr. LeLandais." (Tr. p.

269). He had been assured that the merger vote would be favorable, so he didn't need the aid of LeLandais. It is indisputably established that Stoutenburgh was in his office at Minneapolis, Minnesota on April 19th. Merkin's phone number does not appear on his call charges for that date. I am satisfied upon the entire record before me that no call came from Stoutenburgh to the witness on April 19, 1971.

Mr. LeLandais was confronted again with his pre-trial deposition (Tr. p. 236), and did not repudiate the testimony:

"Q Mr. Stoutenburgh said to you that the private investors would be able to sell after the merger?

A I don't think he put it that way.

Q How did he put it?

A As I said, I told him I was in favor of a merger only for one reason, and that is to provide a way for my stockholders to get out. And he said, 'Well, if we don't get the votes from your stockholders they won't be able to get out.'"

The witness did not ask Mr. Stoutenburgh what he meant by "get out" (Tr. p. 236), he merely assumed that it meant they would receive readily salable unrestricted shares without legends on the certificates. This may well have been an unjustified assumption. Stoutenburgh's conversation is equally susceptable to the inference, warranted by facts known to both parties to the alleged conversation, that Atron, incurring a monthly loss of $200,000.00, faced with loss of the customer responsible for 90% of its sales, terminating purchases, and incapable of developing other markets successfully, was in serious danger, and without recourse to this merger or some alternative merger, the shareholders would not be able to "get out", and the entire investment would dribble away in operating losses.

In addition to relying on the claimed conversation with Stoutenburgh, plaintiffs seek to rely on conversations between LeLandais and John Halsey. Halsey was employed by Merkin & Co. during most of the proxy solicitation period. LeLandais knew Halsey to be Stoutenburgh's brother-in-law, and discussed the subject of free stock with Halsey during that period "many times." However, during that period, although Halsey was a paid proxy solicitor for Atron, LeLandais did not know this fact (Tr. p. 209), and accordingly was not dealing with Halsey in any respect as an agent of Atron or defendants upon whom he or his group could rely. There was motivation to withhold from LeLandais the fact that Halsey was acting as a paid proxy solicitor for Atron because this employment was presumably inconsistent with Halsey's obligations as a full-time employee of Merkin. If Halsey did say anything to LeLandais about free stock, such representations as he might have made may not be imputed to these defendants, or relied on.

LeLandais disclaims any conversation with anybody at Mohawk prior to the effective date of the merger with respect to whether or not Mohawk would be issuing unrestricted certificates to Atron private placement holders (Tr. p. 255).

During the January 29, 1971 meeting, Stoutenburgh raised the question with Mohawk, whether holders of restricted Atron stock would receive freely transferable Mohawk stock should a merger take place, and Wells or Rifenburgh, speaking for Mohawk, gave what Stoutenburgh considered to be an expression of attitude to the effect that "they would issue free stock if they could." (Tr. p. 362).

This fairly stated the attitude and position of Mohawk management, as subsequent events illustrated. Stoutenburgh, Wells and Rifenburgh understood that the problem involved legal matters. There was no discussion in the January 29th meeting of registering the Mohawk stock to be issued in connection with the merger.

Stoutenburgh had no further discussions with Mohawk as to whether Atron restricted shareholders would receive

freely transferable stock. He explained (Tr. p. 264): "I had no other occasion to really do that. They made an expression of attitude. It was simply a matter if legal determinations permitted, free shares would be issued."

On April 30, 1971, Stoutenburgh believed that with the exception of officers, directors and promoters of Atron, free shares would be received. He, as a founder and promoter, was not so benefitted, and at the closing of the merger signed a further restrictive agreement as a promoter. It was not until May 10, 1971, after the merger had been completed that he learned that restricted shareholders of Atron, other than officers, directors and promoters, would not receive freely transferable Mohawk stock.

On May 10th, after the merger, LeLandais raised the problem of transferability of Mohawk shares. Stoutenburgh testified, "I told him that I didn't know anything about it, please contact Mohawk. They are the only people that can answer the question." He testified, and I believe, that this was the first time he learned of any difficulties with respect to receipt of freely transferable Mohawk stock by former Atron shareholders other than promoters.

In conclusion, there is a complete failure of proof with respect to plaintiffs' contentions that the proxy statement was misleading, or omitted to state material facts necessary in order to make the statements therein not misleading, with respect to the question of whether restricted shareholders of Atron would receive unrestricted shares of Mohawk in the merger which could be sold in market transactions without registration under the Securities Act of 1933. Also, plaintiffs failed to prove any cause of action arising out of the restrictive legends placed upon their Mohawk share certificates. This result follows whether their claim be viewed as a violation of Rules 10b-5 or 14a-9 under the 1934 Act, or common law fraud or otherwise, and whether alleged in reliance on oral representations of Stoutenburgh, or others, or written misrepresentations, or omissions in the proxy statement. As to this branch of the litigation, defendants are entitled to prevail in all respects.

The "Accounting Change Deception".

[6] This aspect of the case finds plaintiffs on firmer ground. The proxy statement dated April 16, 1971 remained in effect until the close of the shareholders meeting on April 30, 1971 at which the proxies solicited thereunder were voted in favor of the merger. As was held in Gould v. American Hawaiian Steamship Co., 351 F.Supp. 853, 868 (D.Del.1972), cited with approval in Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973):

"Rule 14a-9 specifically requires that solicitation material which has become false or misleading must be corrected by subsequent materials. Thus, assuming that the . . . proxy materials were accurate when initially approved, the proxy materials should have been amended to reflect subsequent occurrences or changes which rendered the initial disclosure false or misleading. Insofar as they knew or ought to have known that facts originally disclosed subsequently became inaccurate, the directors were under a continuing obligation to make certain that the proxy materials were amended and remained complete and accurate."

The proxy statement furnished plaintiffs contains all of the usual materials needed in order to permit consideration of a corporate merger. Specifically, these include comparative net income statements, comparative book values, dividend records, statement of operations, consolidated statement of income of Mohawk and its subsidiaries, a *pro forma* combined operating statement of Mohawk plus Atron, as well as the comparative historical profitability records of the constituent corporations and financial statements.

Note J to the financial statements, found beginning at page 46 of the proxy

statement, disclosed that Mohawk had rented certain equipment to its customers for various periods and, commencing in 1970, had sold this equipment subject to the leases, to non-affiliated third parties for approximately $4,100,000.00. In the event that the lessees returned the equipment, cancelled their leases or for bad credit or other reasons failed to perform their obligations to make payment, Mohawk had the opportunity to assign substitute leases to the non-affiliated third parties, or substitute equipment leased to the same lessees. In addition, after the expiration of a five year period, the Company would participate in future rentals and have an option to repurchase at salvage value, any or all of such units sold. The proceeds of such "sale", subject to a reserve for doubtful accounts, was booked as an item of revenue in the year in which the sale of the leased equipment to such non-affiliated third parties was made. As of the date of the proxy statement, and previously, this method of accounting, the so-called "financing method" was one of two generally accepted and appropriate principles of accounting for the revenue received by a lessor of property such as Mohawk.

The other generally accepted method was known as the "operating method." The difference between these two accounting methods is that the financing method in effect recognizes the lease, even when not sold to the third party lender, as a sale or loan transaction. The operating method, on the other hand, accounts for revenue from a lease solely as a rental transaction.

Under the financing method, the *excess* of the total rentals to be received under the lease, over the manufacturers' cost of the leased equipment, after giving effect to an adjustment for residual value at the end of the lease, is considered as the consideration payable to the lessor for the investment he has made in the property. Since the transaction is treated as if it were a loan or a sale on the installment basis, that *excess* is taken into account on the accrual basis as profit in the year made, and in periodic amounts on a declining basis depending on the unrecovered cost of the investment of the lessor. See explanation of the expert witness Rosner, Tr. p. 454, et seq. The effect is to bulk a larger portion of the profit via the financing method in the first or early periods of the lease.

Where the operating method is used, the rentals are taken in as accrued as general revenue, and there is charged to the income account of the lessor, or the profit and loss account, any costs of the leased property, such as depreciation of its original cost, maintenance, repairs, bad debt expense and related items. The difference between the rent and these depreciation, maintenance and related costs is the net profit reflected in the income account applicable to the lease itself for the period in which the rent is accrued.

Both accounting methods were in accordance with accepted principles of accounting in 1970 and 1971.

At least prior to November 1971, it was also permissible after a lease had been effected, and booked under the financing method, to "sell" the transaction to a third party. Such third party sales gave rise to income booked in the year of effecting sale, equal to the *full amount* of the entire aforementioned *excess*, or the net rewards to be expected from the leased property over its entire life, with a suitable provision for a reserve for uncollectability or rejection of the leased equipment prior to termination of the lease. This had the practical result of booking as current income monies which in truth could not be said to have been earned fully until some future time when the lessee had fully performed its obligations with respect to the machinery.

Many prestigious corporations engaged in the leasing of equipment and represented in their fiscal affairs by skilled accountants of the highest level of learning and ability, were booking their revenues in accordance with the financing method. These concerns were in effect reporting high profits, in fiscal years prior to full perfomance of obligations, their own and customers, to be performed in the future.

Because use of these accounting principles, permitted by Accounting Principles Board Opinion 7, effective after December 31, 1966 ("APB No. 7") seemed to present an unrealistic picture of the true operating results of corporations manufacturing equipment for sale or lease, the practice came into some disrepute among conservative accountants, beginning earlier than 1971. For example, an "Accounting Interpretation on APB No. 7", issued by the staff of the American Institute of Certified Public Accountants, Inc. (hereinafter the "Institute"—the body which issues APB's) and published in the Journal of Accountancy for November 1971, shortly after the merger, says (p. 78):

> "[T]he sale to a financing institution of property subject to an operating lease, with the manufacturer or dealer effectively retaining the risks of ownership, is not a sale in substance and, therefore, should not be reflected as a sale. Instead, the transaction should be reflected as a loan and income should be recognized under the operating method. (Transactions of these types are in effect collateralized loans from the financing institution to the manufacturer or dealer.) However, the sale of property subject to an operating lease should be reflected as a sale if all risks and rewards of ownership are transferred to the purchaser."

Although the above opinion, clearly critical of the theretofore permissible practice of Mohawk, was not issued until after April 30, 1971, both Mohawk management and its accountants knew that the practice had become subject to professional criticism prior to April 16, 1971, and there had been discussions about changing to the operating method. Neither the existence of the problem, nor the discussions concerning the change were communicated to Atron or plaintiffs prior to the merger, nor were they referred to in the proxy statements.

When a corporation changed from the financing method to the operating method, it would restate its historical income downward, and the amount by which the past income was restated downward would be available to be booked again, when realized, that is, added on to future income. As the expert witness Rosner pointed out (Tr. p. 467): "The profit is still there. It is primarily a question when you record the profit." The profit will be recorded earlier under the financing method.[5]

It is accepted accounting practice to present comparable financial statements for two or more consecutive years. Unless the prior statements were adjusted retroactively, they would not be comparable in the case where a change of accounting principle has been made. Accordingly, it is universal practice where such an accounting change is made, to adjust the prior period retroactively so that the two financial statements will be comparable.

Prior to 1971, Mohawk's fiscal year had ended on July 31st. In 1971, it advanced its fiscal closing from July 31, 1971 to April 30, 1971, so that the nine-month period ending April 30, 1971 constituted a fiscal year, coinciding with the effective date of the merger with

5. Again, at p. 472, the witness pointed out that when a reporting company shifts or changes from the financing method to the operating method of accounting for leased equipment, it decreases its otherwise reportable earnings for the period in which it makes the change and for the prior periods, and its future earnings will be greater than they would have been if it had continued to use the financing method and all other aspects of its business had remained the same. As the witness expressed it, "what had previously been reported as income is adjusted downward, and the income that had previously been recorded is in effect credited to a reserve account and subsequently in future years that income is taken into future income *pro rata* over the life of the lease."

Atron, and with the change in accounting for "sales" of leased machines.

Mohawk effected these two changes as of the close of business on April 30, 1971. There was no disclosure whatsoever of the intended changes in the proxy statement, which spoke as of that date, nor did any of these plaintiffs know about the change when they voted their proxies.

I find that either of the accounting changes taken alone was material, and a failure to disclose them was a material omission. Taken together, the materiality is greater than for either change taken alone. Also material is a statement by management of the reasons or a statement of the operative facts which impelled the changes. See 17 C.F.R. §§ 240.14a-3, 240.14a-101.[6]

Long prior to April 30, 1971, doubts had arisen in the minds of the persons charged with the responsibility for Mohawk's accounting procedures as to the appropriateness of continuing to use the financing method and third-party sales reporting in effect, instant profits from long term leases. Premature terminations of leases which had been the subject of third-party sales had exceeded Mohawk's original expectations by a substantial amount. In addition, certain third-party transactions had not provided the entire sales proceeds in immediate cash for Mohawk. It was reporting these sales as instant earnings, although not receiving the cash flow which the casual reader of a financial statement would associate with the amount of dollars in sales booked during the period.

Wells, Executive Vice President and Treasurer of Mohawk and Rifenburgh, who was President of Mohawk, had, within the scope of their authority, decided, as early as March, 1971, that they would change Mohawk's fiscal year from July 31st to April 30th, and make the change effective for fiscal 1971, so that that year would end three months early. This change in the fiscal year had been approved by the Board of Directors of Mohawk, but the decision to change the fiscal year was not disclosed publicly or announced until May 4, 1971, when it was contained in a press release (Exhibit XY). This change in the fiscal year had various purposes, among which were (a) to facilitate a change to the operating method of reporting earnings, (b) to apply a cosmetic treatment to adverse earnings for the current period, and (c) to eliminate bookkeeping inconveniences suffered with respect to a July 31st closing (Ex. 22). In addition, management wanted to have the new fiscal year coincide with the introduction of a new product line, and put behind itself a period of flat earnings. In order to effectuate the change in Mohawk's fiscal year, its certified public accountants began the audit earlier than usual and before April 30, 1971. They did so pursuant to management's direction.

6. 17 CFR § 240.14a-3 provides:

"No solicitation subject to §§ 240.14a-1 to 240.14a-11 shall be made unless each person solicited is concurrenty furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A."

The instructions for preparation of Schedule 14A are to be found at 17 CFR § 240.14a-101, Item 14, regarding *inter alia*, mergers, require that the proxy statement:

"(b) Furnish the following information as to the issuer and each person which is to be merged into the issuer or into or with which the issuer is to be merged . . . . What is required is information essential to an investor's appraisal of the action proposed to be taken."

In addition, Item 17, entitled "Restatement of Accounts," provides:

"If action is to be taken with respect to the restatement of any asset, capital, or surplus account of the issuer, furnish the following information:

(a) State the nature of the restatement and the date as of which it is to be effective.

(b) *Outline briefly the reasons for the restatement and for the selection of the particular effective date.*

(c) State the name and amount of each account (including any reserve accounts) affected by the restatement and the effect of the restatement thereon . . . .

(d) To the extent practicable, state whether and the extent, if any, to which the restatement will, as of the date thereof, alter the amount available for distribution to the holders of equity securities." (Emphasis added)

In March 1971, Wells and Rifenburgh also decided that commencing May 1, 1971 Mohawk would discontinue the practice of third-party sales. This in itself was a substantial change in the nature of Mohawk's business and should have been disclosed in the proxy statement. It was revealed in an interview with Reuter's News Service on April 19, 1971, but is not set forth in the proxy statement, and no press release was issued prior to the shareholders' meeting on April 30th. There is no evidence that plaintiffs had actual or imputed knowledge of that change.

A day or two following April 22nd, and prior to the shareholders' meeting, the certified public accountants approved and recommended the change from the financing method to the operating method. On April 28, 1971, again prior to the meeting, management's decision had crystallized to the point that Mr. Hengen, Mohawk's public relations officer, was asked to draft an outline for the press release to be issued in conjunction with a meeting with security analysts to be held on May 4th. Additional conversations were held between Wells and Hengen between that date and April 30, 1971. The press release, formally issued on May 4, 1971, but prepared prior to April 30th, discloses the intended change in accounting methods.[7]

The change in accounting alone resulted in a restatement of Mohawk's prior fiscal period ending July 31, 1970, by which revenues were decreased 4%, net income was decreased 18%, and net income per share was dropped \$.50 from \$1.52 to \$1.02. For the short fiscal period of 1971, the income was reduced in the amount of \$1,000,315.00. In addition, other miscellaneous adjustments reducing Mohawk's net income substantially were not disclosed in the proxy solicitation material, although mentioned in the May 4, 1971 press release.

The Court believes that these omissions, all considered together, were material. Income, and earnings per share, traditionally have been considered material in fixing the price or value of stock. Prices of shares are ordinarily quoted in terms of a price-earnings multiple. While sophisticated securities analysts, such as Mr. O. Seaburn Eaton, who testified at the trial, have become accustomed to treating historic earnings statements of electronic data processing equipment companies with a degree of cynicism (Tr. p. 336), these changes were of sufficient magnitude that they should have been disclosed in the proxy statement.

7. By the Agreement and Plan of Merger dated as of March 12, 1971 (Exhibit No. 15) signed by Mohawk, Mohawk expressly warranted to Atron in part as follows:

"3. [Mohawk] has delivered to Atron (a) its consolidated balance sheet as at July 31, 1970, consolidated statements of income and capital in excess of par value and retained earnings for the year then ended and consolidated statement of funds for the year then ended, together with a report of S. D. Leidesdorf & Co., independent public accountants, with respect to such financial statements, and (b) its consolidated balance sheet as at October 31, 1970 and consolidated statements of income and capital in excess of par value and retained earnings for the three months then ended, prepared by [Mohawk]. *Said financial statements and related notes are correct and complete in all material respects and fairly present the financial position (including all known contingent liabilities) of [Mohawk] and its subsidiaries as at the date of each balance sheet and the results of its operations and its use of funds for the respective periods covered by such financial statements.* Such financial statements have been prepared in accordance with generally accepted accounting principles consistently applied throughout the periods involved. Since October 31, 1970 there has been no change in the business, financial condition or results of operations of [Mohawk] except changes in the ordinary course of business which in the aggregate have not been materially adverse or changes which are specifically permitted or required by this Agreement or to which Atron may consent in writing or changes of which [Mohawk] has advised Atron in writing prior to the execution hereof." [Emphasis added]

[7] In a nondisclosure case under Rule 14b–9 as well as Rule 10b–5 [8] plaintiff must show "that the facts in question were material 'in the sense that a reasonable investigator might have considered them important' in making his investment decisions." Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2d Cir., 1974). See also, Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 374 (2d Cir. 1973).

[8] The Court finds that the totality of omissions was material in that plaintiffs, other than ITNR, might have acted differently in connection with the merger. The only thing they could do was to vote "Yes" or "No". Their sole remedy to avoid receiving Mohawk stock which might have appeared unattractive with its earnings restated, would have been to vote "No," and demand an appraisal under the Minnesota statute.

[9] No proof of reliance is necessary in an omission case [Affiliated Ute Citizens v. United States, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 471 (1972); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385 (1970)], and the Court finds that plaintiffs, other than ITNR, have proved all of the elements of their cause of action based on the misleading omission of the accounting and operating information hereinbefore mentioned, and are entitled to recover their provable damages upon that claim.

Damages.

Neither side of this litigation has presented persuasive evidence of the true value of Atron common stock as of April 30, 1971, contrasted with market price.[9] On that date the average bid and asked quotations for Atron were 10¾ and 11¼. On January 29, 1971, when the merger was agreed to and announced, the average price of Mohawk stock was $29.00, and Atron was $8.00.

On March 12, 1971, the date the Agreement of Merger was signed, Mohawk was $34.38 and Atron $7.80. April 16th, the date of the proxy notice, Mohawk was $39.75 and Atron $9.25. On April 30th the relative prices were $44.63 and $10.94.

The Directors of Mohawk, who owed a fiduciary duty to their corporation and its other stockholders, had concluded that the value of Atron was $8.60 per share when they agreed in writing on March 12, 1971 to give a quarter share of Mohawk, then selling at $34.38 per share, for each share of Atron. This agreement, openly arrived at, and negotiated at arms length, at least insofar as Mohawk was concerned, was effected under such circumstances as to estop Mohawk equitably from denying in this action that Atron stock had a value of at least $8.60. There is no persuasive evidence to support any greater value, and the April 30th price of Atron appears solely to have resulted from arbitrage. We consider the intrinsic or investment value of Atron, without regard to any benefits flowing from the Mohawk merger. See discussion *supra*, p. 19.

[10] The measure of damages is compensatory. Plaintiffs are entitled to be placed in the same position they would have enjoyed had they received the omitted information in the proxy statement, and had they voted against the merger, and pursued their dissenting shareholders' rights of appraisal. While the statutory appraisal proceedings would have incurred expenditures for experts and legal fees, as a practical matter, the plaintiffs have incurred at least the same expenses in this litigation, so there is no need to adjust damages to account for the costs of obtaining the remedy in the Minnesota state courts.

8. Certain controlling principles applicable to cases arising under Rule 10b–5 have been held applicable to cases arising under the proxy regulations. See Shapiro v. Merrill Lynch Pierce Fenner & Smith, Inc., 495 F.2d 228, 235 (2d Cir. 1974), and cases cited in footnote 12 therein.

9. Market price of Atron was affected by principles of arbitrage. Any practical investor knew the merger was most likely to be approved and effected—a fact reflected by the market. The greater the certainty and the nearer the date, the greater the arbitrage effect.

It would be speculative and unjustified to assume that the merger would have been defeated if these shares had been voted in the negative. Defendants concede that the merger would have been effected nonetheless. (Post Trial Memorandum, p. 165).

[11] Nor can we accept defendants' contention that without the merger the Atron stock had "for all practical purposes, no intrinsic worth whatever" (*ibid*, p. 165). While Atron's prospects were not good, it could have been merged with some other concern or liquidated, and Mohawk is equitably estopped, as previously noted, to deny that Atron was worth the value it paid or gave to acquire the merged company.

I decline to find that the changes in accounting methods or the discontinuance of third-party sales or any combination of such events, was the cause in the decline in price of Mohawk stock between May 3, 1971 and August 25, 1971, the date of filing of the Registration Statement. This decline was caused by a myriad of independent factors operating together, affecting the stock market in general, and computer shares in particular. However, the losses which the plaintiffs suffered do meet the test of causation set forth in *Schlick*, *supra*, which held that both

> "*loss causation*—that the misrepresentations or omissions caused the economic harm—and *transaction causation*—that the violations in question caused the [plaintiff] to engage in the transaction in question" (507 F.2d at p. 380)

must be shown

> "in order to state a Section 14(a) claim: transaction causation to show a violation of the law from which [a plaintiff] may recover, and loss causation to show damages." (507 F.2d at p. 382)

[12] The omissions, as we have held, violated the proxy rules and the regulations promulgated thereunder. But for such violation, plaintiffs might have voted against the merger, exercised their appraisal rights as dissenting shareholders, and avoided damage. Such "but for causation" is a sufficient basis to fasten liability. *Cf.* Pearlstein v. Scudder & German, 346 F.Supp. 443 (S.D.N.Y. 1972), on remand from order in 429 F. 2d 1136 (2d Cir. 1970).

[13] Coronet effected a short sale on May 5, 1971 (Pre-Trial Order, ¶ 33). It realized a profit when it covered the short sale. It did this inadvertently, and acting in the mistaken belief that it was selling the freely transferable shares of Mohawk which it expected, unjustifiably, to receive as a result of the merger. The Court gives no consideration in fixing damages to the profit realized on the short sale. If plaintiffs' free stock deception theory were sustained, we would credit this amount as the result of action in mitigation of damages. However, Coronet was acting as a result of an inexcusable mistake. It knew or should have known its Mohawk shares were restricted. Had it suffered a loss in covering the May 5th short sale, such loss would not have been chargeable to the defendants here, since the Court does not sustain the free stock deception theory. Accordingly, equitable principles require that we treat the profit realized on the short sale no differently than we would have treated the loss. The same conclusion applies to the short sale profits of plaintiff RSI (Pre-Trial Order, ¶ 34).

[14, 15] The Registration Statement became effective August 25, 1971. At that time, plaintiffs came under an obligation to mitigate their damages arising out of their acquiescence in the merger, which the Court finds to have been caused by a misleading proxy statement. A thirty day period following August 25th would seem to represent a reasonable time within which plaintiffs should have disposed of their Mohawk shares so as to mitigate their damages, and any plaintiff holding Mohawk shares after September 25, 1971, is considered by the

Court to have made a new investment decision. *Cf. Pearlstein, supra.*

The lowest price during that period for replacement was $21.50 per share.[10]

We compute and award damages as follows:

Coronet:	
Value of 21,250 shares Atron at $8.60 —	$182,750.00
Value of 5,312 shares Mohawk at $21.50 —	−114,208.00
Damages	$ 68,542.00
Creative:	
Value of 16,250 shares Atron at $8.60 —	$139,750.00
Value of 4,062 shares Mohawk at $21.50 —	− 87,333.00
Damages	$ 52,417.00
RSI:	
Value of 10,000 shares Atron at $8.60 —	$ 86,000.00
Value of 2,500 shares Mohawk at $21.50 —	− 53,750.00
Damages	$ 32,250.00
LeLandais & Co.:	
Value of 6,334 shares Atron at $8.60 —	$ 54,472.40
Amount realized September 9, 1971 on sale of 1,583 shares Mohawk (Pre-Trial Order, ¶38)	− 43,250.00
Damages	$ 11,222.40

It is of no significance that of Coronet's shares, 5,000 are still held. There is no basis for any rescission in this case, and Coronet will be amply compensated by money damages representing the difference between the value of its Atron stock and the value of its Mohawk shares on the date when it should have acted in mitigation of damages. Any damages suffered since that date are deemed the result of an independent cause, or a new investment decision to retain the Mohawk shares. Compensatory damages for loss, of which the breach of statutory duty is the proximate cause, will be adequate. *Cf. Pearlstein, supra.*

[16] As heretofore noted, ITNR shares were not voted either for or against the merger. The failure of ITNR to vote either (1) against the merger, so as to be entitled to appraisal under the Minnesota statutes, or (2) for the merger, so as to be entitled to claim that it suffered damages as a result of the false and misleading proxy statement, bar any recovery on its part. Breach of the duties imposed by Rule 14a–9 were not the proximate cause of its damages.

Recovery shall be joint and several as against Atron, MDS-Atron, and Mohawk, each of which is regarded as a joint tortfeasor with respect to the violations found.

Defendant Stoutenburgh is entitled to a judgment of dismissal for lack of personal jurisdiction.

Defendant Richard L. Karpen, a director of Atron and a Vice President and director of Mohawk during 1971, showed affirmatively to my satisfaction that his conduct was free of wrongdoing. The complaint is dismissed as against him for failure of proof.

[17] The Court declines as a matter of discretion to award counsel fees, believing that the damages hereinbefore set forth are adequate to compensate plaintiffs under all of the circumstances of this case, and further because the litigation has been unduly complicated and extended by plaintiffs' act of joining the free stock deception theory claim, which the Court finds lacking in merit, for trial with a relatively simple and clear cut claim under Rule 14a–9. In so doing, plaintiffs imposed greater burdens on the defendants and the Court than would have been the case if the portion of the claim which the Court finds meritorious had been asserted alone.

The foregoing, together with the stipulated facts set forth in the pre-trial order shall constitute the findings of fact and conclusions of law in this case pursuant to Rule 52, F.R.Civ.P.

10. Coronet sold 312 shares of Mohawk on November 9, 1971 at $5,970.17. Creative sold 4,062 shares on November 30, 1971 at $60,-459.36, and RSI sold 2,500 shares during November, 1971 at $41,260.20, LeLandais & Co. sold 1,583 Mohawk shares on September 9, 1971 for approximately $43,520.00 (Pre-trial Order, p. 15).

Our Clerk is directed to enter Judgment in favor of the plaintiffs jointly and severally against MDS-Atron, Inc. and Mohawk, only in the amounts set forth on p. 52, *supra*, all with interest at 6% per annum from April 30, 1971 to the date of entry of Judgment, and costs, all pursuant to Rule 58(1), F.R. Civ.P., and shall also enter Judgment that all relief shall be denied to plaintiff ITNR, and dismissing as to defendants Stoutenburgh and Karpen.

APPENDIX C

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twentieth day of July, one thousand nine hundred and seventy-six.

Present:

HON. WALTER R. MANSFIELD,
HON. WILLIAM H. TIMBERS,
HON. HENRY J. FRIENDLY,
Circuit Judges.

PIERRE J. LELANDAIS & CO. INC.,
PIERRE J. LELANDAIS, RESEARCH & SCIENCE INVESTORS, INC., etc.,
Plaintiffs-Appellees-Appellants
v.
MDS-ATRON, INC., and MOHAWK DATA SCIENCES CORP.,
Defendants-Appellants-Appellees

Docket No. 75-7108

A petition for a rehearing having been filed herein by counsel for the plaintiffs-appellees-appellants

Upon consideration thereof, it is

Ordered that said petition be and

hereby is denied.

s/ A. Daniel Fusaro
A. DANIEL FUSARO,
Clerk.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the 20th day of July, one thousand nine hundred and seventy-six.

PIERRE J. LELANDAIS & CO. INC.,
PIERRE J. LELANDAIS, RESEARCH & SCIENCE INVESTORS, INC., etc.,
Plaintiffs-Appellees-Appellants
v.
MDS-ATRON, INC., and MOHAWK DATA SCIENCES CORP.,
Defendants-Appellants-Appellees

Docket No. 75-7108

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the plaintiffs-appellees-appellants,

and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

s/ Irving R. Kaufman
IRVING R. KAUFMAN,
Chief Judge.

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(5692)

IN THE

Supreme Court of the United States

October Term, 1976

No. 76-690

PIERRE J. LELANDAIS & CO., INC.; PIERRE J. LELANDAIS; RESEARCH & SCIENCE INVESTORS, INC.; INTERCONTINENTAL TECHNOLOGY & NATIONAL RESOURCES; CORONET FUND and CREATIVE CAPITAL FUND,

Petitioners,

against

MDS-ATRON, INC.; MOHAWK DATA SCIENCES CORP.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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Of Counsel

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BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the United States District Court for the Southern District of New York (Appendix B to Petition at 11a)* is reported at 387 F. Supp. 1310 (S.D.N.Y. 1974) and at CCH [1974-1975 Transfer Binder] FED. SEC. L. REP. ¶94,930. The unanimous opinion of the United States Court

* Unless otherwise indicated, references are to pages of the Appendices annexed to the Petition. References to pages of the Joint Appendix in the Court of Appeals are preceded by the letters "JA".

of Appeals for the Second Circuit (Appendix A to Petition at 1a) is reported at —— F.2d ——, and at CCH [1975-1976 Transfer Binder] FED. SEC. L. REP. ¶95,539. The orders of the United States Court of Appeals for the Second Circuit denying petitioners' petition for a rehearing *en banc* by that court (Appendix C to Petition at 34a) are not reported.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition.

Questions Presented

This private proxy fraud case presents *no* issue worthy of review by this Court. It raises *no* conflicts among the Circuits, and presents *no* substantial questions of law. Rather, it is but an effort to obtain review of a decision of the United States Court of Appeals for the Second Circuit which applied the traditional principle that damages may not be awarded in the absence of proof that damages have been suffered.

Both the District Court and the Court of Appeals concluded that petitioners failed to present any proof of actual damages. However, the District Court awarded damages because it developed, *sua sponte* and after trial, an equitable estoppel theory as a substitute for proof of actual damages. The trial had not been conducted in reliance upon that theory. Instead, in the three-day bench trial, as the Court of Appeals found, petitioners "had ample opportunity . . . to adduce proof of what actual damages, if any, they sustained" (9a).

Upon appeal, the Court of Appeals held the equitable estoppel theory invalid, and ruled that proof of actual damages was necessary. Because the trial had not been conducted in reliance upon the equitable estoppel theory, and because petitioners had been given "ample opportunity" to prove damages (9a), the Court of Appeals

> "made an independent search of the record ourselves to see if there is *any* proof of actual damages, whether adduced by plaintiffs or by anyone else. We have found none." (8a; emphasis in original)

The Court of Appeals therefore concluded that petitioners, who failed to prove their case in their first trial, were not entitled to a second trial to present additional proof.

In light of the foregoing, the sole question raised by the petition for certiorari is:

> Whether it was an abuse of discretion for the Court of Appeals to remand this case to the District Court with instructions to dismiss, rather than with instructions to conduct a second trial to allow petitioners to attempt to prove damages which they failed to prove, although having ample opportunity to do so, at their first trial.

Statutes Involved

The pertinent provisions of the Securities Exchange Act of 1934 ("1934 Act"), §28(a), 15 U.S.C. §78bb(a), and of the Judicial Code, 28 U.S.C. §2106, are set forth in the Petition (at 3-4).

Statement of the Case

This petition for certiorari concerns the question of damages arising from alleged fraudulent misrepresentations in a proxy statement issued in connection with a stock-for-stock merger of two corporations. After trial, the United States District Court for the Southern District of New York held petitioners here to be entitled to damages, defined as the difference between the value of what petitioners gave up on the merger and the value of what they received in exchange. In other words, the District Court applied an appropriate variant of the traditional out-of-pocket tort theory of damages normally employed in fraud cases.

On appeal, neither the litigants nor the Court of Appeals questioned the propriety of employing that standard damage theory. However, what the Court of Appeals found unacceptable was an award of damages in this case by the District Court in the absence of *any* evidence that the value of what petitioners gave up was any greater than the value of what they received. Petitioners simply never established any injury: offering no evidence of the value of what they gave up, they failed to establish the crux of their case. In consequence, the Court of Appeals reversed and remanded, with instructions to dismiss the action.*

The Merger

On April 30, 1971, the shareholders of Atron Corporation ("Atron") voted, by a margin of 924,756 to 3,600, to approve a merger of Atron into MDS-Atron, Inc., a wholly-

* The Court of Appeals thus never reached the question, also raised on appeal by respondents here, of whether liability had been proven in the first place (9a-10a).

owned subsidiary of respondent Mohawk Data Sciences Corp. ("Mohawk") (JA 61). Atron was an unprofitable manufacturer of peripheral computer equipment, 90% of which was sold to a single customer: Mohawk (15a; JA 922). Pursuant to the merger, the former Atron shareholders received one share of Mohawk stock for every four shares of Atron previously held. Five of the petitioners here were among the overwhelming majority voting for the merger; petitioner Intercontinental Technology & National Resources ("ITNR") never voted.*

Pursuant to Minnesota law, which controlled the transaction, those Atron shareholders who objected to the merger could have insisted upon an appraisal and, thus, have obtained the "fair cash value" of their Atron stock instead of Mohawk stock. Minn. Stat. Ann. §§301.40, 301.44 (West 1969) (4a-5a). In fact, no Atron shareholder exercised this right of appraisal (5a; JA 61).

The Issues at Trial

Because the Atron stock which they had held was restricted, petitioners received similarly "lettered" Mohawk stock as of the date of the merger, April 30, 1971. Subsequently, on August 25, 1971, all of the petitioners, save ITNR, received unrestricted Mohawk stock in exchange for their restricted Mohawk stock (19a-21a; JA 62-63).

The petitioners commenced this lawsuit approximately one year after the merger, at a time when, for unrelated

* According to the Court of Appeals, "ITNR did not vote either way on the merger because the record holder of its stock did not forward to ITNR the proxy material in time for it to vote." (3a, n.2)

reasons, the market price of Mohawk stock had fallen sharply.* Their prime theory was that they had been promised that they would receive unrestricted, not restricted, Mohawk stock in exchange for their restricted Atron stock as of the date of the merger; the District Court found this claim to be wholly without merit (5a; 25a). Petitioners also argued that the proxy statement issued in connection with the merger omitted to state certain material facts in violation of Sections 10(b) and 14(a) of the 1934 Act (5a).

Specifically, petitioners argued that it was a material omission not to have disclosed that, prior to the merger, Mohawk had determined to change its fiscal year from one ending on July 31 to one ending on April 30 (5a). Mohawk had indeed made that determination, but had not thought it of sufficient importance to include in the proxy statement (28a).

Additionally, petitioners objected to the omission to disclose information concerning a change in one of Mohawk's methods of marketing some of the computer devices which it manufactured (29a). In 1970, Mohawk began to experiment with the practice of selling some of the computers which it had placed on long-term leases to unaffiliated third parties, subject to certain guarantees by Mohawk. Mohawk accounted for such sales by the so-called "financing method" which, in effect, booked all anticipated net revenues re-

* The District Court expressly declined to find that the decrease in the market price of Mohawk stock from May, 1971 through August, 1971 was in any way related to the "facts" which petitioners claimed should have been disclosed in the proxy statement. Instead, it found that the decline

> "was caused by a myriad of independent factors operating together, affecting the stock market in general, and computer shares in particular." (31a)

lating to any such machine in the year of the sales transaction involved. During 1970, only about 4% of Mohawk's net revenues involved this sort of third-party sale of leased equipment (JA 183, 562). Mohawk had determined to stop using this financing technique prior to the merger. However, while the decision to abandon this minor financing technique had been disclosed to the commercial press before the merger, Mohawk did not mention this decision in the proxy statement, not believing it to involve any substantial change in the nature of its business (JA 981-82).

Also, prior to the merger, Mohawk had begun to consider changing its method of accounting for such lease/sales from the above-described "financing method" to the so-called "operating method", pursuant to which net revenues were booked only as received and, thus, spread out over the life of the lease.* Respondents argued on appeal that there was no evidence sufficient to sustain the District Court's conclusion that a decision to change this method of accounting had actually been made *prior* to the merger and should have been disclosed. Since the Court of Appeals only addressed the damage question, it did not reach this issue (9a-10a).

* In petitioners' statement of facts, it is implied that some "impropriety" was involved in the use of the "financing method." However, the District Court expressly found that both the "financing method" and the "operating method"

> "were in accordance with accepted principles of accounting in 1970 and 1971" (26a; 387 F. Supp. at 1325)

and that

> "Many prestigious corporations engaged in the leasing of equipment and represented in their fiscal affairs by skilled accountants of the highest level of learning and ability, were booking their revenues in accordance with the financing method" (26a-27a; 387 F. Supp. at 1325-1326).

One consequence of Mohawk's switch from one to the other acceptable method of accounting was to defer to subsequent years the booking of certain income allocable to this 4% segment of its business. Consequently, Mohawk's reported income for 1970 was restated downward, and its 1971 results were less than would have been reported had the "financing method" been retained (JA 492-93). While, like any other change in accounting methods, this switch altered the stated income of Mohawk, it had no impact upon the underlying business reality which the accounting statements endeavored to report.

The District Court's Findings

After a three-day trial without a jury, the District Court found that respondents had violated Section 14(a) of the 1934 Act by failing to disclose their intentions (1) to change Mohawk's fiscal year and (2) to abandon the brief experimentation with third-party sales, and (3) by failing to disclose their alleged intention to change the accounting for such sales from one acceptable method of accounting to another equally acceptable method.* The District Court held these omissions to be material because "a reasonable investor *might* have considered them important" (30a; 387 F. Supp. at 1329; emphasis supplied).**

* Petitioners, as noted, brought their action under both Sections 10(b) and 14(a) of the 1934 Act. However, the trial court made no findings as to scienter, a vital element of any Section 10(b) claim. See *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976); *Republic Technology Fund, Inc.* v. *Lionel Corp.,* 483 F.2d 540, 551 (2d Cir. 1973), *cert. denied,* 415 U.S. 918 (1974). Liability, therefore, was based solely on the Section 14(a) claim.

** The trial court employed an improper standard of materiality. As this Court has now made clear, a proxy statement omission is not material unless it can reasonably be held that the omitted information

(footnote continued on next page)

Having found liability, the District Court proceeded to determine damages. It held that the proper measure of damages in this case was the difference between what petitioners gave up in the merger (their statutory right of appraisal of the fair cash value of their Atron stock) and the value of what they received upon the merger (one share of Mohawk stock for every four shares of Atron stock). As the District Court said:

> "The measure of damages is compensatory. Plaintiffs are entitled to be placed in the same position they would have enjoyed had they received the omitted information in the proxy statement, and had they voted against the merger, and pursued their dissenting shareholders' rights of appraisal." (30a; 387 F. Supp. at 1329)

Petitioners, on appeal, acknowledged that this was an appropriate method of measuring damages (Brief of Plaintiffs at 11-16). The Court of Appeals accepted the propriety of the District Court's theory of damages (6a). Respondents agreed that, if any damages were due, this was indeed the way to measure them.

The above holding represents the crux of the petition for certiorari. Under the standard formula applied by the District Court, an award of damages is dependent upon a showing of the value of the appraisal rights in Atron stock, and a further showing that such appraisal value was more than the value of the Mohawk stock issued in exchange. Petitioners declined to make *any* such showing.

would have been likely to have affected an investor's actions. *TSC Industries, Inc.* v. *Northway, Inc.,* —— U.S. ——, 96 Sup. Ct. 2126 (1976). On their appeal, respondents argued this point and contended that petitioners had failed to prove any properly-defined material omission. However, since the Court of Appeals determined at the outset that there was no proof that petitioners had been damaged, it never reached the issue of materiality.

Instead, at trial, petitioners argued that damages should be awarded on the basis of a novel "benefit-of-the-bargain" theory derived from contract law. The District Court, however, rejected that approach. Petitioners have not (and, in good faith, could not have) argued on appeal to the Court of Appeals, or in their present petition for certiorari to this Court, that it was an error of law or abuse of discretion for the District Court to decide to apply the standard tort theory of damages in this case. Indeed, in their petition for rehearing in the Court of Appeals, petitioners expressly conceded that they were "not contending that this Court erred in adopting an 'appraisal' value measure of damages . . . ." (Petition of Plaintiffs for Rehearing at 5.) Rather, petitioners now seek by indirection to question the correctness of the District Court's theory, but they failed to challenge that theory on appeal to the Court of Appeals. (Brief of Plaintiffs at 11-16.)

The problem was not with the District Court's theory of damages—a theory which was substantively sound and is now procedurally unassailable.* The problem—as the Court of Appeals found—was with the District Court's application of that theory to the record in this case.

Specifically, although the District Court found that there was no persuasive record evidence of the true value of Atron stock on the day of the merger (30a), it nevertheless proceeded to award $164,431.40 in damages to the petitioners. The District Court acknowledged that the fair cash value of the Atron stock should be determined by an analysis of its asset value, market value and investment (or earnings) value (21a). But, petitioners offered no expert

* See pp. 18-19, *infra.*

opinion as to the fair cash value of Atron stock, and the District Court ignored the ample record evidence that, by any of the aforementioned tests, the fair cash value of the Atron stock was *less* than that of the Mohawk stock given in exchange.

Instead of making a meaningful and realistic evaluation, the District Court attempted to remedy the deficiencies in petitioners' proof by invoking—really inventing—an "equitable estoppel" theory, which none of the parties had argued (30a). It held, without any basis or authority, that respondents were "estopped" from denying that the fair cash value of an Atron share in connection with the merger was worth anything less than one-fourth of the market value of a Mohawk share on March 12, 1971, or $8.60 per Atron share. (March 12, 1971 was the date "as of" which Mohawk and Atron formally agreed to the merger proposal, an agreement which had been reached in principle and publicly announced earlier, on January 29, 1971; the merger took place on April 30, 1971.) (30a)

The Issues on Appeal

On appeal, the Court of Appeals found that there was no legal justification for the invocation of this unrequested, unbriefed and unprecedented notion of an equitable estoppel: Mohawk had simply never represented to anyone that a share of Atron stock was worth $8.60 in cash at any time (8a). Indeed, it would have been most imprudent for Mohawk to have done so, since the Atron stock was objectively worth only a fraction of that amount.

The Court of Appeals, however, did not simply rely upon the District Court's finding that there was no evi-

dence as to the true value of the Atron stock. Instead it "made an independent search of the record . . . to see if there is *any* proof of actual damages, whether adduced by plaintiffs or by anyone else." (8a; emphasis in original) It found none:

> "Absent the estoppel theory which we reject, our careful examination of the record discloses that plaintiffs failed to prove the value of what they gave up when they voted for, rather than against, the merger. In terms of Minnesota law, they failed to prove the 'fair cash value,' i.e., the appraisal value, of their holdings of Atron stock as of the date the merger was authorized. Loss of the value of their appraisal rights is the underpinning of their claim of damages. In short, they failed to prove what actual damages, if any, they sustained as a result of the exchange." (8a-9a)

The Court of Appeals further observed that the "record is clear" that petitioners "had ample opportunity to present whatever proof [of damages] they had. They declined to do so." (9a, n. 6)

Given the total absence of any proof of injury, the Court of Appeals had no alternative but to reverse and remand with directions to dismiss. By deciding on that basis, it was not necessary for the Court of Appeals to reach any of the several substantial questions respondents had raised on appeal relating to the basic issue of liability.

POINT I

The decision below is clearly correct.

A. The courts below applied the appropriate measure of computing damages, and properly found that petitioners failed to prove any injury.

Petitioners attempt to transform a narrow factual issue —the failure to prove damages—into a legal issue worthy of certiorari by arguing that "the Court of Appeals erred in announcing an exclusive rule for measurement of merger fraud damages," thereby rejecting the advice set forth in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 386 (1970), that District Courts should exercise "sound discretion" in selecting suitable and flexible remedies under Section 14(a) of the 1934 Act (Petition at 2).

The Court of Appeals announced *no* such exclusive rule here. Instead, it merely found that, on the record in this case, there was a total absence of *any* proof of damages, under the standard fraud measure of damage applicable to these facts.

Both the District Court and the Court of Appeals used the same approach in calculating damages: damages were the difference between the value of the Atron stock which petitioners gave up, and the value of the Mohawk stock which they received (6a; 30a). In addition, both the District Court and the Court of Appeals concluded that petitioners failed to prove the first half of that formula—the value of the Atron stock—even though they were given ample opportunity to do so (8a; 30a).

The only reason the District Court awarded petitioners damages was that the District Court developed, *sua sponte* and after trial, an equitable estoppel theory as a substitute for proof of the value of the Atron stock. The District Court concluded that Mohawk was "estopped" from denying that the fair *cash* value of the Atron stock, at the time of the merger, was less than the proportionate *market* value of the Mohawk stock offered in exchange on the day "as of" which the merger agreement was signed (30a-31a).

The Court of Appeals held this approach invalid, stating that it amounted to holding Mohawk to an agreement to pay cash for the Atron stock, an offer which Mohawk never made (8a).

Petitioners mischaracterize the Court of Appeals' holding when they state that the court "held that the value which defendants placed on plaintiffs' stock could not be considered as evidence of the value of that stock." (Petition at 10) There is nothing in the Court of Appeals' opinion which suggests that Mohawk's valuation of the Atron stock was inadmissible evidence which could not be considered in computing damages. The market value of Mohawk stock was not held to be incompetent evidence; but, obviously, the market value of Mohawk stock on March 12, 1971 was inadequate evidence, standing alone, to prove the fair cash value of the stock of another company, Atron, six weeks later, on the date of the merger, April 30, 1971.

Upon concluding that the District Court's employment of an equitable estoppel doctrine was invalid, the Court of Appeals, as noted,

> "made an independent search of the record ourselves to see if there is *any* proof of actual damages, whether

> adduced by plaintiffs or anyone else. We have found none." (8a; emphasis in original)

Indeed, the evidence in the record all pointed in the opposite direction. Not only did petitioners fail to prove any damages, but they could *not* have done so. There simply were none.

Atron was a failing company. It had lost money in every period since its inception (JA 561). In January of 1971, the company learned that, in addition to losing money, it was about to lose what amounted to its sole customer: Mohawk (JA 420). At the time of the merger, Atron had no profits, no customers, no future and ever dwindling reserves (JA 442, 783-84). On the day of the merger, April 30, 1971, Atron stock had no per share income value, never having had any income. According to Atron's own books, the per share net asset value was in the neighborhood of $3.00 (JA 557, 582).

There was a thin over-the-counter market for Atron stock (JA 54-57). The District Court correctly found that, subsequent to the January 29, 1971 announcement of the Atron/Mohawk merger plans, the Atron market was controlled by arbitrage (30a, n. 9). Thus, given the announced one-for-four exchange ratio, the quotations for Atron stock, after January 29, 1971, essentially reflected 25% of the prevailing market price for Mohawk stock on the New York Stock Exchange, where it traded. During the period from January 4 through January 29, 1971, before the merger was announced, the average bid price for Atron stock was approximately $6.88 (JA 791). These bids, however, occurred prior to any public disclosure that Atron's single largest customer, Mohawk, was about to start manu-

facturing the very product it had been buying from Atron. Absent a merger, the disclosure of that fact could only have sent Atron stock prices crashing.

The fact that Mohawk was willing to offer a premium in its own "paper" for Atron stock does not alter this analysis. As the Court of Appeals concluded, it is a fact of commercial life that paper flows far more freely than cash, and it is a common experience that acquiring companies offer such premiums (8a).*

Under all the circumstances, it seemed apparent, as respondents argued on appeal, that the fair cash value of the Atron stock on the date of the merger, April 30, 1971, however measured, was in the range of $3 to $4 per share, substantially less than the value of the Mohawk stock given in exchange.

On April 30, 1971, Mohawk stock was selling for $44.64 per share. Thus, the value of a quarter Mohawk share received by the owner of a single Atron share was, on that date, $11.16—about three times the fair cash value of an Atron share (30a). These petitioners, it is true, did not receive unrestricted Mohawk stock until August 25, 1971. On that date, the market price of Mohawk was $28.38 or $7.09 per quarter share—still twice the true value of the Atron

* The conclusion of the Court of Appeals on this point is most apt, and worthy of quotation in full:

> "The stock-for-stock exchange here, as defendants point out, was based on the fact of commercial life that paper flows more freely than money. Furthermore, it is not uncommon for a company proposing a merger to offer a price including a premium which reflects a special value of the target company to the company proposing merger or is regarded as a necessary inducement to the voting shareholders of the target company to accept the proposal." (8a)

stock on April 30.* (Brief of Defendants in Court of Appeals at 34 n.) Petitioners, in their post-trial memorandum in the District Court, conceded that the value of each Mohawk share received by them on April 30 was $28.25, or $7.06 per quarter share. (*Id.* at 34)

Nevertheless, in calculating damages, the District Court, inexplicably, did not use the actual market price of Mohawk stock on April 30, 1971, or on August 25, 1971, to determine the value of such stock to Atron shareholders. Instead, it held that the relevant value of Mohawk stock was the *lowest* price at which Mohawk stock sold in the 30-day period after August 25 (32a). The District Court compounded its error by holding that such price was $21.50 (or $5.38 per quarter share), a price which was lower than the lowest price at which Mohawk stock actually traded in that 30-day period. (Brief of Defendants in Court of Appeals, Table B3)

On appeal, respondents argued that this was an indefensible way to measure the value of the Mohawk stock given to petitioners in connection with the merger on April 30, 1971. However, even at the $5.38 valuation, we argued, the Mohawk stock which petitioners received was worth significantly more than the fair cash value of the Atron

* As previously noted (p. 6 n., *supra*), the District Court declined to find that the decrease in Mohawk's market price during the summer of 1971 was related to the "facts" which petitioners claimed should have been disclosed in the proxy statement (31a). Indeed, the news about Mohawk's change in fiscal year and decision to abandon the financing device of selling leased machines to third parties, which the District Court held should have been disclosed before the merger, was in fact disclosed at a meeting of securities analysts on May 4, 1971. On that date, Mohawk closed at $44\frac{7}{8}$—up slightly from its price on the day of the merger. On May 5, 1971, a full day after this allegedly momentous disclosure, Mohawk closed off $\frac{1}{8}$, at $44\frac{3}{4}$. (Brief of Defendants in Court of Appeals, Table B3.)

stock which they gave up. While not necessary for the Court of Appeals to decide this question, it did observe that

> "it seems fairly clear that the bottom line would be negative even if we were to take the Mohawk stock at the much lower value it had when plaintiffs were able to sell the restricted stock issued in respect of their restricted Atron shares" (9a, n.6).

It is thus apparent that the Court of Appeals' conclusion on damages was not only well-founded, but fair. Petitioners did not, and could not, prove any damages.

B. The courts below properly rejected petitioners' contract theory of damages.

At trial, petitioners argued that they should receive damages based on a contract theory. They claimed that they had been promised Mohawk stock worth $44.64 per share and that they were entitled to the benefit of that "bargain." Even though petitioners had speculatively retained their Mohawk stock for months or years after they were free to sell it,* they argued that their damages were the difference between $44.64 and the price at which they eventually sold Mohawk. Neither the District Court nor the Court of Appeals saw any merit in this contract damage theory (6a; 30a). Petitioners were unable to cite a single proxy fraud case where damages were in fact awarded pursuant to any such formula.

Indeed, although petitioners presented their contract theory of damages, as an alternate approach, to the Court of Appeals, they acknowledged that the tort measure of

* Some of petitioners were still holding their Mohawk stock at the time of trial (JA 63).

damages employed by the District Court was an appropriate one. (Brief of Plaintiffs at 11-16) Having conceded the issue before the Court of Appeals, petitioners should not be permitted to raise it here. *Cort* v. *Ash*, 422 U.S. 66, 73-74 n.6 (1975).

Petitioners here cite two cases which they claim authorize some sort of contract theory: *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and *Chasins* v. *Smith, Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970). Neither case in fact advances petitioners' position.

As to *Mills*, petitioners refer to a brief dictum in which Mr. Justice Harlan suggested that, in the context of a derivative action, damages could, under some circumstances, perhaps be computed by awarding plaintiffs the value of that which was represented as coming to them. As the Court of Appeals here pointed out (7a, n.5), plaintiffs in this type of case are very fond of selectively quoting from Mr. Justice Harlan's opinion, but always take special pains to avoid quoting that passage in which he stated that:

> ". . . damages should be recoverable only to the extent that they can be shown" (396 U.S. at 389).

As noted, petitioners showed no such damages here.

The *Chasins* case is, on its face, inapplicable since it arose from a violation of Section 10(b) of the 1934 Act, not Section 14(a), as here. However, the damage theory employed in *Chasins* is not fundamentally inconsistent with the theory used here. Chasins purchased certain securities at the recommendation of his broker without having been informed that the broker was making a market in those very

securities (438 F.2d at 1169-70). If Chasins had known this fact, presumably he would not have purchased the securities. The court thus endeavored to return Chasins to the *status quo ante* by awarding him the difference between the purchase price, and the deflated price at which he subsequently sold such securities. Chasins, however, unlike the petitioners here, started off with cash. (*Id.* at 1173.)

As noted, petitioners here, *status quo ante,* held restricted stock in a failing company. Unlike Chasins, they did not lose cash, but only lost the statutory right to the appraised fair cash value of their stock. That is precisely what the District Court here endeavored to give back to them: the value of their appraisal rights. That value is precisely what these petitioners failed to prove.

Petitioners received Mohawk stock which they held for appreciable periods as a speculative investment. For unrelated reasons, the investments soured (31a). Petitioners, we suggest, then proceeded to pore over the proxy statement in the hope of finding some arguable omission, upon which they could base a proxy fraud claim and seek to recover from Mohawk the paper losses which they experienced as a result of their own speculations.

To allow damages to be measured by such losses on subsequent speculation would fly in the face of the express provision of the 1934 Act that no person shall receive an award "in excess of his actual damages on account of the act complained of." (15 U.S.C. §78bb(a)). To adopt such a principle would be to convert every proxy statement into a potential insurance policy against all subsequent capital losses. That was not the purpose of the 1934 Act. Not only

was it within the discretion of the courts below to decline to apply petitioners' contract theory of damages to the facts here, we submit, but it was incumbent upon them to refuse to do so.

POINT II

There is no conflict of decision among the Circuits.

Petitioners seek review on the ground that the decision below conflicts with a 1973 decision of the United States Court of Appeals for the Seventh Circuit in *Swanson* v. *American Consumers Indus., Inc.*, 475 F.2d 516 (7th Cir. 1973). The *Swanson* case was fully briefed below, and the Court of Appeals here was apparently persuaded by respondents' argument that, far from a conflict, *Swanson* required the very result reached here.

Petitioners cite *Swanson* for the proposition that, in a stock-for-stock merger, the fair cash appraisal value of the stock of the acquired company should be no less than the proportionate market value of the stock of the acquiring company issued in exchange. Petitioners, however, omit to advise this Court that the two companies involved in *Swanson* had reached a pre-merger agreement as to what *was* the fair cash value of the Peoria Service Company stock being acquired. As stated in the *Swanson* trial court opinion,

> "The total exchange evaluation of about $285,000 was based on the anticipated liquidation value of those assets." (328 F. Supp. 797, 803 (S.D.Ill. 1971))

Thus, the defendant in *Swanson* had expressly agreed that each share of Peoria Service Company stock had a fair

cash value of \$3.55, the figure which the court in *Swanson* used as the appraisal value.

If Mohawk had ever agreed that Atron stock had a fair cash value of \$8.60 per share—the value determined under the District Court's equitable estoppel doctrine—we would have a very different case here. But that did not occur. As the Court of Appeals here stated:

> "... at no time did Mohawk represent to the Atron shareholders that their shares had a fair cash value of \$8.60 per share .... The merger was a stock-for-stock exchange, not a stock-for-cash one. Whatever might be said regarding an estoppel approach if the merger had been a stock-for-cash one, we are not called upon to decide that issue." (8a)

There is nothing in the record which suggests that Mohawk ever hinted a willingness to pay anything like \$8.60 cash for a share of Atron.

The Seventh Circuit in *Swanson* held that, upon proof of a Section 14(a) proxy fraud in a stock-for-stock merger, damages should be measured by the difference between the value of the appraisal rights given up and the value of the stock received in exchange. That holding is absolutely consonant with the conclusions of the Second Circuit in the present case. In *Swanson,* the record established the cash value of the abandoned appraisal rights; injury was proved and damages could be awarded. On the instant record, there was *no* evidence that the appraisal rights which petitioners waived were worth one penny more than the Mohawk stock which they received. Indeed, the evidence was to the contrary.

Thus, there is no conflict among the Circuits on this principle.

POINT III

There is no substantial question of law for this Court to review.

The only remaining question raised in the petition is whether it was an abuse of discretion for the Court of Appeals not to remand this matter for receipt of further evidence on damages. The question, we submit, is frivolous.

The decision whether to remand for a new trial, or simply reverse and direct dismissal of the complaint, rested in the sound discretion of the Court of Appeals. (28 U.S.C. §2106) That discretion was not abused. The Court of Appeals, as previously noted, reviewed the record and reflected carefully upon what petitioners declined to prove and what respondents carefully demonstrated: the minimal fair cash value of Atron common stock.

Petitioners now contend that they failed to prove damages only because they "could not reasonably [have] anticipated" the method of computing damages employed by the Court of Appeals. (Petition at 13) First, petitioners state that the Court of Appeals in effect invented the "appraisal" theory of damages, ignoring the clear fact that the District Court first applied this obvious approach. Petitioners go on to state,

> "In doing so the Court of Appeals acknowledged that it previously had not discussed this newly-announced 'apprisal' [sic] method of calculating damages in §14(a) actions." (Petition at 12)

But the Court of Appeals acknowledged no such thing. To the contrary, it pointed to *Gerstle* v. *Gamble-Skogmo,*

Inc., 478 F.2d 1281, 1303-08 (2d Cir. 1973), as a clear precursor of the present approach:

> "[In *Gerstle*], we had a very complicated problem as to the measure of damages for a false proxy statement. A somewhat simplified statement of our result was that we allowed the minority stockholders of the merged company to recover the amount actually obtained on sales of certain properties concerning which undervaluing misrepresentations had been made, plus the value of other assets at the date of merger, less the market value of the stock which the minority stockholders received. This is not altogether unlike an estimate of what would be obtained on an appraisal, although we did not put it in those terms." (9a)

Petitioners try to avoid the precedential force of *Gerstle*, but the effort is unconvincing. Petitioners assert that,

> "Only in *Gerstle* v. *Gamble-Skogmo Inc.*, 478 F.2d 1281 (2d Cir. 1973), had [the Court of Appeals] ever before considered §14(a) damage questions, and admittedly neither the phraseology nor the computational methodology of that decision previewed adoption of the 'appraisal' method announced in the present action." (Petition at 12-13)

Contrary to petitioners' assertion as to what the Second Circuit "admitted" here, that Court, as we have just seen, expressly characterized *Gerstle* as a preview of this case.* Petitioners' suggestion of surprise, therefore, is out of order.

Nor could petitioners have been "surprised" by reason of the Court of Appeals' invalidation of the District Court's

* It should be noted in passing that petitioners' apparent suggestion that the damage theory in *Gerstle* somehow differs from the instant theory undercuts their other argument that the Second Circuit here announced an exclusive rule for measuring damages in Section 14(a) cases. (Petition at 9)

equitable estoppel theory. As noted above, the District Court developed that theory only *after trial*, and after petitioners had been given "ample opportunity" to present whatever proof they had on the damage issue (9a). Petitioners' failure at trial to prove the fair cash value of Atron stock, therefore, was by no means caused by their reliance on that erroneous theory of law—but by their lack of any evidence.

When a Court of Appeals concludes, as it did here, that a plaintiff has been given ample opportunity to prove his case, and simply has failed to do so, it is entirely appropriate for the Court of Appeals to reverse, and order the complaint dismissed, rather than remand for a second trial. See *United States* v. *Generes*, 405 U.S. 93, 106 (1972); *Neely* v. *Eby Constr. Co.*, 386 U.S. 317, 321 (1967); *Insurance Co. of North America* v. *Chinowith*, 393 F.2d 916, 920 (5th Cir.), *cert. denied*, 393 U.S. 990 (1968). Indeed, the sound use of judicial resources compels that result; if a plaintiff was given a full opportunity to prove damages in his first trial, and failed, he is not entitled to a second bite at the apple.

The Court of Appeals in this case followed quite the same approach employed by this Court in *United States* v. *Generes*, *supra*. The plaintiff there had prevailed at trial and on appeal in an action for a tax refund. This Court determined that the trial court had given an erroneous jury instruction, on a question of apparent first impression, which was favorable to the plaintiff. That error required reversal. Instead of remanding for a new trial, however, this Court "examined the record," and found nothing which could support a verdict for the taxpayer. This Court, therefore, directed entry of judgment for the Government.

The situation here is even stronger. Not only did petitioners not prove their damages at trial, they have never—neither here nor in their petition for rehearing to the Court of Appeals—articulated one scrap of evidence they would adduce, if given the second chance, to show that the fair cash value of the Atron stock they gave up was greater than the value of the Mohawk stock they received. On the other hand, respondents, both in the Court of Appeals and here, have endeavored to show that the reverse is true.

Contrary to petitioners' contention, the approach of the Court of Appeals in this case is consistent with the approach used by the same Court in *Chris-Craft Indus., Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973) (*"Chris-Craft II"*), *after remand*, 516 F.2d 172 (2d Cir. 1975), *cert. granted*, 425 U.S. 910 (1976) (*"Chris-Craft III"*),* and also with the holdings in *Edina State Bank* v. *Mr. Steak, Inc.*, 487 F.2d 640 (10th Cir. 1973), *cert. denied*, 419 U.S. 883 (1974), and *World Prods., Inc.* v. *Central Freight Serv., Inc.*, 342 F.2d 290 (3d Cir. 1965). In each of those cases, the appellate court found that the trial record showed that the plaintiffs were entitled to some damages, or to greater damages than had been awarded by the trial court; those cases were remanded so that the plaintiffs could receive awards that the Circuit courts were persuaded plaintiffs should have won. Here, we have the reverse.

The rulings of law in *Chris-Craft* and this case are consonant; the only difference is in the facts. In *Chris-Craft*

* Petitioners' citation of *Chris-Craft* is touched with a special irony since two of the three judges who sat on the panel of the Court of Appeals which decided this case (Friendly, Mansfield, Timbers, JJ.) also sat on the panel which decided *Chris-Craft III* (Mansfield, Oakes, Timbers, JJ.).

III, the Court of Appeals found that the record showed proof of damages, and the court thus directed entry of judgment awarding those damages. In this case, the record showed a failure to prove damages, and the Court of Appeals thus directed that the complaint be dismissed.

Conclusion

No purpose would be served by issuing a writ of certiorari in this case. There is no conflict among the Circuits as to the legal principle applied below, *i.e.*, that only actual damages may be awarded to claimants under the 1934 Act, and no damages may be awarded at all unless they have been proven. Here there was no such proof.

Petitioners complained that they were injured as a result of a stock-for-stock merger but, at trial, they declined to provide evidence of the true value of what they gave up on this exchange—much less, evidence that what they received was worth less than what they gave up for it. For this reason, the Court of Appeals was compelled to conclude that petitioners had failed to prove their case. In so doing, the Court of Appeals announced no new rule, but merely applied basic principles to this record.

It was not an abuse of discretion for the Court of Appeals to decide this case upon the trial record and to direct dismissal. Petitioners have no right to a second chance to produce evidence of injury—evidence which even now they are unwilling or unable to identify.

In short, the decision below should not be disturbed and need not be reviewed.

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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